

**BEFORE THE
INDIANA UTILITY REGULATORY COMMISSION**

**PETITION OF THE BOARD OF DIRECTORS
FOR UTILITIES OF THE DEPARTMENT OF
PUBLIC UTILITIES OF THE CITY OF
INDIANAPOLIS, AS SUCCESSOR TRUSTEE
OF A PUBLIC CHARITABLE TRUST, D/B/A
CITIZENS GAS & COKE UTILITY FOR (1)
AUTHORITY TO INCREASE ITS RATES AND
CHARGES FOR GAS UTILITY SERVICE AND
APPROVAL OF A NEW SCHEDULE OF
RATES AND CHARGES APPLICABLE
THERE TO, (2) AUTHORITY, TO THE EXTENT
NECESSARY AS AN ALTERNATIVE
REGULATORY PLAN, TO RECOVER THE GAS
COST COMPONENT OF ITS NET WRITE-OFFS IN
ITS GAS COST ADJUSTMENT FILINGS,
(3) AUTHORITY PURSUANT TO 170 IAC 5-1-27(F)
FOR A NON-GAS COST REVENUE TEST TO
DETERMINE WHEN DEPOSITS ARE REQUIRED
FOR EXTENSION OF FACILITIES, (4) APPROVAL
OF OTHER CHANGES TO ITS GENERAL TERMS
AND CONDITIONS FOR GAS SERVICE, AND (5)
APPROVAL OF NEW DEPRECIATION ACCRUAL
RATES**

CAUSE NO. 43463

FILED

MAR 19 2008

**INDIANA UTILITY
REGULATORY COMMISSION**

**DIRECT TESTIMONY AND EXHIBITS OF
CAREY B. LYKINS and
JOHN R. BREHM**

**On Behalf of Petitioner,
Citizens Gas & Coke Utility**

Volume I

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March 18, 2008

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1. The first part of the report is a general introduction to the subject of the study. It discusses the importance of the study and the objectives of the research. It also provides a brief overview of the methodology used in the study.

2. The second part of the report is a detailed description of the study area. It includes information about the location of the study area, the population of the study area, and the characteristics of the study area. It also discusses the data sources used in the study.

3. The third part of the report is a description of the methodology used in the study. It includes information about the data collection methods, the data analysis methods, and the statistical tests used in the study.

4. The fourth part of the report is a description of the results of the study. It includes information about the findings of the study, the conclusions drawn from the findings, and the implications of the findings.

5. The fifth part of the report is a discussion of the study. It includes information about the strengths and weaknesses of the study, the limitations of the study, and the suggestions for future research.

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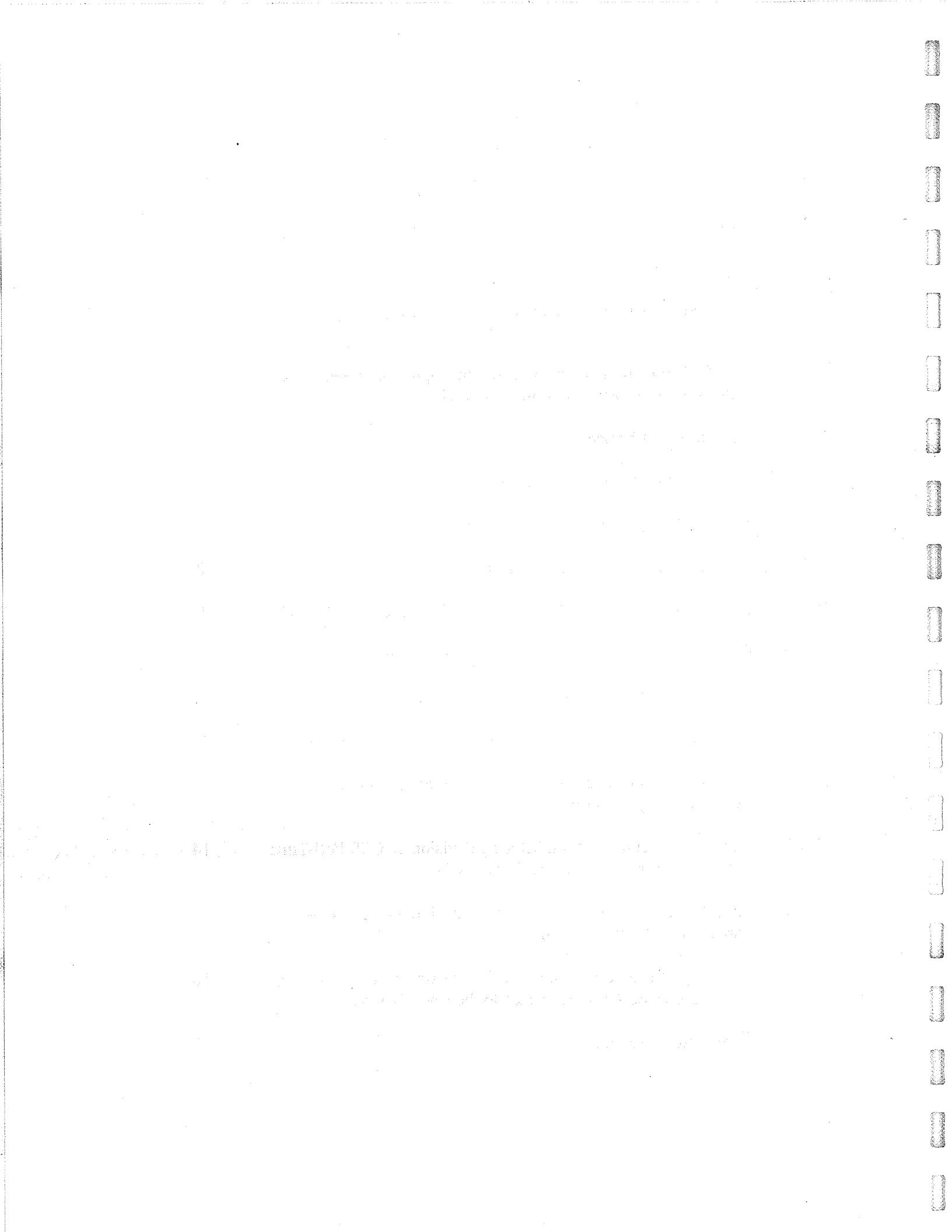
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CAUSE NO. 43463

**DIRECT TESTIMONY
of
CAREY B. LYKINS**

**On
Behalf of
Petitioner
Citizens Gas & Coke Utility**

Petitioner's Exhibit CBL

1 **INTRODUCTION AND PURPOSE**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Carey B. Lykins. My business address is 2020 North Meridian
4 Street, Indianapolis, Indiana.

5 **Q. BY WHOM ARE YOU EMPLOYED?**

6 A. I am employed by the Board of Directors for Utilities (the "Board") of the
7 Department of Public Utilities (the "Department") of the City of Indianapolis (the
8 "City"). The City is the successor trustee of a public charitable trust and acting
9 through the Board manages and controls the municipally-owned gas utility that is
10 the Petitioner in this proceeding and does business as Citizens Gas & Coke Utility
11 ("Petitioner" or "Citizens Gas").

12 **Q. PLEASE GENERALLY DESCRIBE YOUR DUTIES AND**
13 **RESPONSIBILITIES AS THEY RELATE TO CITIZENS GAS.**

14 A. I am the President and Chief Executive Officer of Citizens Gas. I have broad
15 responsibility for developing, coordinating and managing the implementation of
16 long-term strategic objectives for Citizens Gas.

17 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
18 **BACKGROUND.**

19 A. In 1973, I received the degree of Bachelor of Science in Finance from Indiana
20 University. I received the degree of Master of Business Administration from
21 Indiana University in 1981. In May 2003, I completed the Advanced Executive
22 Program at Northwestern University's Kellogg School of Management. I am a
23 Certified Public Accountant.

1 I began my employment with the Board in 1973 and progressed through
2 positions of increasing responsibility in Customer Services, Rates and Finance. I
3 served as Vice President of Customer Services and Rates from June 1990 to July
4 1994 and as Vice President of Customer Services and Finance from July 1994 to
5 December 1997. In December 1997, I became Vice President and Chief Financial
6 Officer. I was promoted to Senior Vice President and Chief Financial Officer in
7 January 2000 and held that position until March 2003, when I was appointed
8 Executive Vice President and Chief Operating Officer. I was named President
9 and Chief Executive Officer in October 2005.

10 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

11 A. Yes. I have testified before this Commission in a number of proceedings,
12 including Petitioner's most recent general rate case, Cause No. 42767.

13 **Q. ARE YOU GENERALLY FAMILIAR WITH THE BUSINESS,**
14 **PROPERTIES AND FINANCIAL CONDITION OF CITIZENS GAS?**

15 A. Yes, I am.

16 **Q. HAVE YOU READ THE VERIFIED PETITION CITIZENS GAS FILED**
17 **INITIATING THIS PROCEEDING?**

18 A. Yes. I have read the Verified Petition and am familiar with its contents. A copy
19 of the Verified Petition is attached as Petitioner's Exhibit CBL-1.

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
21 **PROCEEDING?**

22 A. My testimony provides information in support of the relief requested by Petitioner
23 in the Verified Petition. My testimony first provides an overview of the Board,

1 the public charitable trust it is entrusted with managing and the municipal gas
2 utility known as Citizens Gas. Next, I will discuss the relief Citizens Gas is
3 requesting and the circumstances surrounding that request. Lastly, my testimony
4 will provide an overview of the testimony of the other witnesses who are
5 testifying on behalf of Citizens Gas in this proceeding.

6 **Q. PLEASE SUMMARIZE THE PRINCIPAL POINTS MADE IN YOUR**
7 **TESTIMONY.**

8 A. In the last 15 years, Citizens Gas has requested an increase to its base rates only
9 twice, including the request made in this proceeding. The prior request was made
10 in 2004. We are proud of the efficiencies and cost reductions that have allowed
11 us to avoid base rate increases, but, at least in the near term, we believe more
12 frequent increases in smaller amounts will better serve Citizens Gas, our
13 customers and other stakeholders. The overall cost of operating the gas utility has
14 risen and we believe will continue to rise. That combined with the continuing
15 phenomenon of declining usage per customer simply will not allow us to replicate
16 another extended period without the need for a base rate increase.

17 At the same time, credit rating agencies continue to express to us their
18 concerns about our ability to implement a timely increase to our rates after the
19 Board has concluded an increase is needed. Admittedly, when we filed our last
20 case, we had waited too long to seek a rate increase and compounded that
21 problem by filing an overly complicated case—mistakes we will avoid going
22 forward. One principal objective we have in this case is to make it as

1 straightforward as possible and avoid disputes that could increase the length of
2 time required to obtain the relief we need.

3 We have worked with the OUCC and industrial intervenors to achieve
4 positive outcomes in a number of recent cases involving Citizens Gas and its
5 sister steam utility, Citizens Thermal Energy. We look forward to building on
6 those successes and working with the parties in this case in an attempt to resolve
7 it in a manner that is satisfactory to everyone. Regardless of whether the case is
8 settled or not, however, concluding it in a time frame that will enhance our
9 position with the credit rating agencies is vital to us; and we are committed to
10 doing our part to achieve that outcome.

11 **OVERVIEW OF THE BOARD AND PUBLIC CHARITABLE TRUST**

12 **Q. PLEASE DESCRIBE THE BOARD.**

13 A. The Board is the governing body of the Department, which is an executive
14 department of the City of Indianapolis. The powers of the Board are set forth in
15 Indiana Code Section 8-1-11.1-3. Pursuant to those statutory powers, the Board
16 currently owns two municipally-owned utilities, Citizens Gas and a steam utility
17 doing business as Citizens Thermal Energy, as well as a number of other
18 businesses.

19 **Q. PLEASE DESCRIBE THE PUBLIC CHARITABLE TRUST FOR WHICH**
20 **THE BOARD SERVES AS SUCCESSOR TRUSTEE.**

21 A. In 1887, a group of Indianapolis citizens created a gas company to operate as a
22 public charitable trust, solely for the benefit of the City and its inhabitants and to
23 resist a threatened monopoly and predatory pricing by a privately-owned

1 company. The citizens who founded that company believed the public charitable
2 trust would remain viable throughout the years and continue to deliver low-cost,
3 high-value and excellent-quality energy services to the City and its inhabitants.
4 The Citizens Gas Company of Indianapolis was created in 1906 to succeed the
5 original gas company and serve as trustee of the public charitable trust. The City
6 of Indianapolis replaced the Citizens Gas Company of Indianapolis as successor
7 trustee of the trust in 1935 and, acting by and through the Board, continues to
8 operate Citizens Gas and Citizens Thermal Energy to fulfill the purposes for the
9 creation of the public charitable trust, which include supplying heat, light and
10 power to the City and its inhabitants.

11 **Q. PLEASE DESCRIBE THE GOVERNANCE STRUCTURE OF THE**
12 **BOARD.**

13 A. The Board is made up of seven persons who are selected and appointed annually
14 by the Department's five-member board of trustees. Each trustee serves a four-
15 year term after being nominated by the board of trustees and appointed by the
16 Mayor of the City of Indianapolis. Each person serving on the Board and the
17 board of trustees must be at least 35 years of age and a resident of the City for at
18 least five years preceding his or her appointment.

19 **Q. TO WHOM ARE THE BOARD OF TRUSTEES, THE BOARD AND**
20 **CITIZENS GAS ACCOUNTABLE?**

21 A. Because of the unique structure of the public charitable trust, the board of
22 trustees, the Board and Citizens Gas are accountable to a number of different
23 entities in a number of ways. The Mayor or City-County Council of Indianapolis

1 may seek to remove any trustee from office for neglect of duty, incompetence,
2 disability to perform his or her duties or other good cause. Directors serving on
3 the Board may be removed summarily at any time by the board of trustees. The
4 Board must make quarterly reports to the City Controller of all funds it receives
5 and expends. Additionally, the Board must, on or before December 31 of each
6 year, furnish the City Controller an estimate of all proposed expenditures for the
7 next calendar year. The books, accounts, records and transactions of the Board
8 are subject to examination, audit, and supervision by the Indiana State Board of
9 Accounts. Of particular relevance to this proceeding, Citizens Gas cannot put into
10 effect new rates or terms and conditions of service without first obtaining the
11 Commission's approval. And, unlike other municipally-owned utilities, Citizens
12 Gas cannot seek to remove itself from the Commission's jurisdiction.

13 Finally and most importantly, the Board has a fiduciary duty to act in the
14 best interests of the beneficiaries of the public charitable trust, which comprises
15 the customers of Citizens Gas. That fiduciary duty includes, among other things,
16 a duty of loyalty that mandates the Board and its members put the interests of
17 Citizens Gas's customers above their own or any other stakeholder. Citizens
18 Gas's fiduciary duty and undivided loyalty to its customers is at the heart of
19 everything we do.

1 Q. EARLIER YOU MENTIONED THAT THE BOARD OWNS A NUMBER
2 OF OTHER BUSINESSES. WHAT OTHER BUSINESSES BESIDES THE
3 TWO MUNICIPALLY-OWNED UTILITIES DOES THE BOARD OWN?

4 A. The assets of the public charitable trust also include a district cooling system
5 serving downtown Indianapolis, certain oil interests in Greene County, Indiana
6 and the stock of Citizens By-Products Coal Company ("By-Products"), a West
7 Virginia corporation that has existed for many years. By-Products engages and
8 invests in a variety of energy-related businesses.

9 The Board formerly operated a coke manufacturing plant. As a result of a
10 number of problems that plagued our coke manufacturing business in recent
11 years, including the bankruptcy of several customers, foreign competition, coal
12 shortages, high coal prices, environmental problems and more, the Board directed
13 management to close the manufacturing plant in 2007.

14 Q. HAS CLOSURE OF THE COKE MANUFACTURING PLANT
15 AFFECTED CITIZENS GAS?

16 A. Yes. As Mr. Brehm discusses in his prepared testimony, closure of the coke
17 manufacturing plant has affected the amount of Corporate Support Services or
18 "CSS" costs and the allocation of those costs.

19 Q. DOES OPERATION OF CITIZENS GAS AS PART OF THE PUBLIC
20 CHARITABLE TRUST PROVIDE BENEFITS TO THE UTILITY'S
21 CUSTOMERS?

22 A. Absolutely. I believe the unique nature of our organization creates much value
23 for the customers of Citizens Gas. Our relationship with our customers is defined

1 by the purposes for which the public charitable trust was created. There are no
2 shareholders who profit from the success of Citizens Gas. Rather, as discussed
3 above, the Board is entrusted with a fiduciary duty to the inhabitants of the City of
4 Indianapolis, and one of its principal missions is to reliably and safely meet the
5 demands of Citizens Gas's customers at the lowest cost reasonably practical—
6 both today and in the future. Indeed, all of the business activities the Board
7 engages in, regulated and unregulated, are intended ultimately to benefit our
8 municipal utility customers.

9 I believe the Board's interests are aligned with those of the Commission
10 and the Indiana Office of Utility Consumer Counselor (the "OUCC"). While we
11 may disagree from time to time with positions taken by the OUCC, we respect the
12 agency's role as an advocate for ratepayers and its stated mission to "represent all
13 Indiana consumers to ensure quality, reliable utility services at the most
14 reasonable prices possible." Likewise, I believe the Commission's mission
15 statement, "to assure that utilities and others use adequate planning and resources
16 for the provision of safe and reliable utility services at reasonable cost," is
17 strikingly similar to our own.

18 **OVERVIEW OF CITIZENS GAS**

19 **Q. PLEASE GENERALLY DESCRIBE CITIZENS GAS.**

20 A. Citizens Gas is one of the largest gas utilities in the State of Indiana and the
21 largest that is municipally-owned. Citizens Gas has been providing gas utility
22 service in the City of Indianapolis for over a hundred years and currently provides
23 service to over 265,000 customers in and around Marion County. Our customers

1 include hospitals, schools and universities, manufacturers, retailers, commercial
2 office buildings and residential consumers. In order to provide safe, reliable and
3 low cost service to our customers, Citizens Gas owns, operates and maintains a
4 variety of plant and equipment. Our facilities include, among other things, over
5 4,000 miles of gas pipelines, an operations center, two liquefied natural gas
6 ("LNG") plants and underground storage facilities. Citizens Gas's two LNG
7 plants and underground storage facilities are capable of storing approximately 9
8 billion cubic feet of natural gas that enhances the security and reliability of our
9 system and also provides a hedge against spikes in the market price of natural gas.

10 Mr. Chris Braun, Petitioner's General Manager of Gas Operations, discusses in
11 more detail in his prepared testimony utility plant and equipment owned and
12 operated by Citizens Gas.

13 **Q. YOU STATED ABOVE THAT ONE OF THE BOARD'S PRINCIPAL**
14 **MISSIONS IS TO RELIABLY AND SAFELY MEET THE DEMANDS OF**
15 **ITS MUNICIPAL UTILITY CUSTOMERS AT THE LOWEST COST**
16 **REASONABLY PRACTICAL. CAN YOU PROVIDE SOME RECENT**
17 **EXAMPLES OF STEPS CITIZENS GAS HAS TAKEN TO FULFILL**
18 **THAT MISSION?**

19 **A.** Yes. More than 70 percent of customers' gas bills consists of the cost Citizens
20 Gas incurs to purchase natural gas commodity supplies on their behalf.
21 Consequently, much of our efforts are focused on creating and taking advantage
22 of opportunities to lower commodity costs, which are passed through to customers
23 as part of our gas cost adjustment tracking mechanism. We recently completed

1 two successful initiatives that have resulted in lower commodity costs and will
2 produce substantial savings to customers for years to come.

3 The first initiative is a prepaid gas program. As a result of recent
4 clarifications in the U.S. tax laws, tax exempt entities can take advantage of their
5 ability to issue tax exempt financing and structure transactions that facilitate
6 purchases of natural gas at a discount to the market price of gas. Citizens Gas
7 worked with the Indiana State Treasurer's Office, the Indiana Bond Bank, the
8 City of Batesville and the Town of Lapel to form the Indiana Municipal Gas
9 Purchasing Authority ("IMPGA") for the purpose of implementing a prepaid gas
10 purchase program that is available to all municipally-owned gas utilities in
11 Indiana. In July 2007, Citizens Gas, Batesville, Lapel, the Bond Bank and the
12 IMPGA completed the first prepaid transaction through which Citizens Gas will
13 purchase about 3.5 Bcf of gas annually at a discount of \$0.44 per dekatherm from
14 market index prices. Over the 15-year life of the transaction, the prepaid gas
15 program will save our customers approximately \$24 million.

16 The second initiative involves the completion of the Heartland Gas
17 Pipeline in Southern Indiana. The Board, through its By-Products subsidiary and
18 its affiliate, ProLiance Energy, LLC, formed Heartland Gas Pipeline, LLC, which
19 constructed a 25-mile intrastate gas pipeline that connects our underground
20 storage fields in Worthington, Indiana to the Midwestern Gas Transmission
21 System near Sullivan, Indiana. That connection gives Citizens Gas access to
22 affordable gas supplies from the Western United States and Canada. Since the
23 Heartland Gas Pipeline was placed in service in December 2006, it has delivered

1 more than \$4.5 million in savings to the customers of Citizens Gas, and we expect
2 as much as \$3.2 million of ongoing annual savings.

3 **Q. WHAT OTHER STEPS DOES CITIZENS GAS TAKE TO HELP ITS**
4 **CUSTOMERS MANAGE THE COMMODITY PORTION OF THEIR GAS**
5 **BILLS?**

6 A. The price of natural gas has become much more volatile in recent years. In
7 addition to our LNG and underground storage facilities, we utilize hedging
8 instruments to reduce the effects of price volatility and minimize our customers'
9 exposure to spikes in the market price of natural gas. All of the hedging
10 instruments are tied to physical volumes of natural gas required to serve
11 customers. Our use of hedging instruments increases the accuracy of our gas
12 price forecasts and reduces variances that have to be reconciled in quarterly gas
13 cost adjustment proceedings. It is important to understand that our hedging
14 strategy is not intended to ensure Citizens Gas will be able to lock in future gas
15 purchases at prices below the actual market price at the time gas is purchased and
16 delivered. Rather, hedging is a strategy employed solely to mitigate the effects of
17 price volatility for our customers.

18 **Q. HAS CITIZENS GAS'S HEDGING STRATEGY RESULTED IN MORE**
19 **STABLE PRICES FOR CUSTOMERS?**

20 A. Yes, it has. For the period July 2005 through May 2008, NYMEX contract
21 trading ranges fluctuated between \$4.89 and \$14.99 per Dth, a range of \$10.10
22 per Dth. During that same time frame, average physical hedge purchase prices

1 fluctuated between \$6.26 and \$9.71 per Dth, a range of only \$3.45 per Dth,
2 resulting in significantly more stable gas prices for our customers.

3 **Q. HOW DOES CITIZENS GAS MANAGE ITS NON-COMMODITY**
4 **COSTS?**

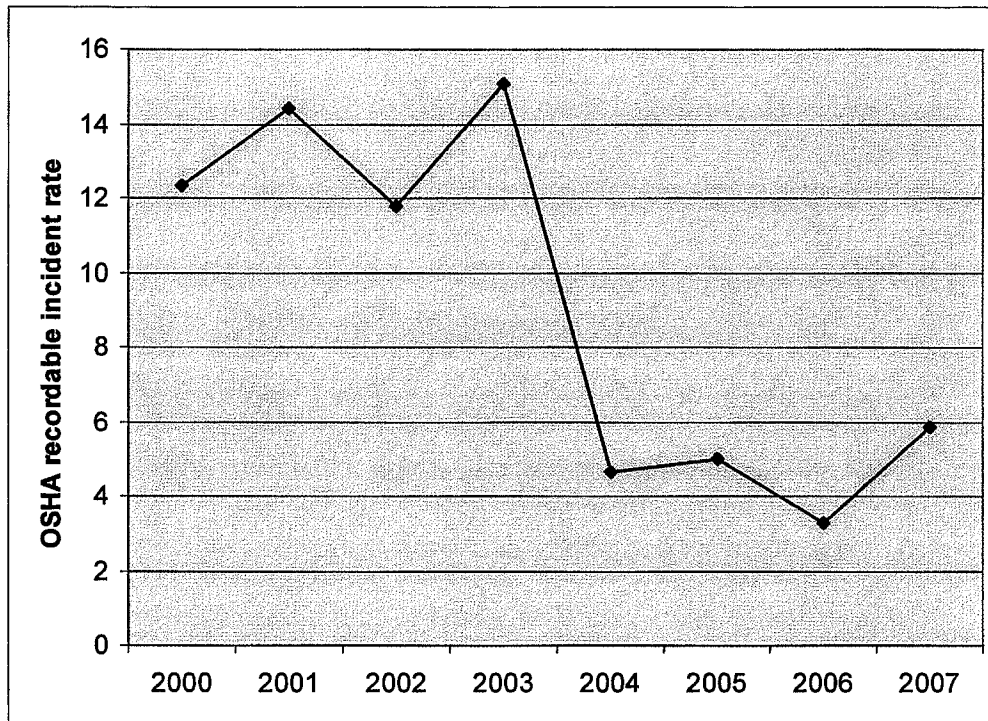
5 We continually strive to reduce non-commodity costs (such as the cost of
6 operating and maintaining the gas distribution system) and at the same time
7 improve customer service and efficiency. For example, Citizens Gas actively
8 participates in the American Gas Association's Operations Best Practices
9 Benchmarking Program. The AGA Best Practices Program focuses on the areas
10 of distribution, LNG and transmission operations and utilizes a collaborative
11 process where participants study an agreed to set of topics and identify solutions
12 to improve service and lower costs. Mr. Braun discusses in his prepared
13 testimony the AGA Best Practices Program and other efforts Citizens Gas
14 undertakes to improve service and reduce gas supply and operating costs.

15 Another area where Citizens Gas strives for continuous improvement is
16 safety in the workplace. Of course, the principal reason to improve safety is to
17 reduce the likelihood of injuries to our employees, but improved safety has
18 financial consequences as well. Work-related injuries can result in claims and
19 lost work time that drive up the cost of operating the utility. Over the last several
20 years, we have taken a number of steps to improve safety, including:

- 21 • Centralized the Safety Department Trust-wide, under the leadership of a
22 Safety Director;

- 1 • Increased senior management's focus on safety by forming a Strategic Safety
2 Team, including Senior Vice Presidents of Operations and Administration,
3 Vice Presidents of Operations, Human Resources and Engineering, the Safety
4 Director and me;
- 5 • Upgraded an incident management system to better track incidents that
6 potentially could result in injury;
- 7 • Increased emphasis on safety training, including defensive driving, the use of
8 electronic devices while driving, use of personal protective equipment and
9 engineering safeguards; and
- 10 • Improved response time following identification of operational needs, such as
11 fire resistant uniforms for maintenance employees.

12 The chart below shows the overall decrease in the OSHA recordable incident
13 rate Citizens Gas has experienced since 2000, which I attribute to the initiatives
14 described above and the good work of our employees in responding to the
15 increased emphasis on safety. As the chart demonstrates, our average annual
16 OSHA recordable incident rate over the last four years has leveled off to about 35
17 percent of the average rate experienced in the prior four-year period.



1

2 Q.

3

4

**WHAT DOES CITIZENS GAS DO TO IMPROVE SAFETY FOR
CUSTOMERS AND THE INTEGRITY OF ITS GAS DISTRIBUTION
SYSTEM?**

5 A.

6

7

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9

We take our customers' and the general public's safety very seriously. Citizens Gas is in the process of replacing all cast iron, wrought iron and bare steel pipe in our system, which will cost approximately \$50 million over several years. We believe the enhancements to reliability and safety resulting from replacement of this aging infrastructure will be well worth the investment.

10

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12

13

As discussed in more detail by Mr. Braun in his testimony, Citizens Gas is ahead of schedule in terms of compliance with federal regulations governing pipeline safety that were promulgated as a result of the Pipeline Safety Act of 2002. Additionally, as also discussed by Mr. Braun, Citizens Gas has effective

1 leak detection procedures and has recently made a number of operational
2 improvements that increase the safety of our system, including shortening leak
3 response times and upgrading fire protection and security equipment at our LNG
4 plants.

5 But our concern for customer safety doesn't stop at the meter. In 2006, we
6 formed a partnership with the Indianapolis Fire Department and local churches
7 through the Interdenominational Ministerial Alliance to raise awareness of home
8 heating safety as well as energy assistance programs available to our customers.
9 The partnership uses a variety of media to communicate the importance of
10 working smoke detectors and home evacuation plans, the dangers of space heaters
11 and energy assistance information. Additionally, in the past two years, the
12 partnership distributed more than 30,000 smoke detectors to customers throughout
13 the City of Indianapolis.

14 **Q. EARLIER YOU MENTIONED THE UTILITY'S COMMITMENT TO**
15 **CUSTOMER SERVICE. PLEASE DESCRIBE THAT COMMITMENT.**



16 **A.** Citizens Gas's commitment to customer satisfaction is paramount. We participate
17 in the Baldrige National Quality Program administered by the U.S. Department
18 of Commerce that provides a framework for organizations to improve their
19 overall performance. The annual Baldrige assessment, conducted by an
20 independent examiner, measures performance in several categories including
21 customer and market focus, which involves an examination of Citizens Gas's
22 relationship with its customers in a number of respects and how we determine our
23 customer's requirements and expectations. Using the Baldrige criteria leads to

1 an integrated approach that ensures improvements in one area, such as efficiency,
2 are not gained at the expense of another area, such as customer satisfaction.
3 Continuous improvement, which is one of our core values, is an underlying
4 philosophy of the Baldrige criteria and self-assessment process.

5 **Q. WHAT ELSE DOES CITIZENS GAS DO TO IDENTIFY CUSTOMER**
6 **NEEDS AND IMPROVE CUSTOMER SERVICE?**

7 A. We pay close attention each year to the results of the J.D. Power and Associates
8 ("J.D. Power") Gas Utility Residential Customer Satisfaction Study. J.D. Power
9 is "a global marketing information firm that conducts independent and unbiased
10 surveys of customer satisfaction, product quality and buyer behavior."¹ Among
11 our 22 Midwest gas utility peers, we have been ranked by J.D. Power first once,
12 twice two times and fourth and fifth once in the past five years. As shown on the
13 chart below from J.D. Power's Web site, in the most recent study, Citizens Gas
14 was rated by J.D. Power as "among the best" in four of six key categories,
15 including overall customer satisfaction, and "better than most" in the other two
16 categories.

¹ Source: <http://www.jdpower.com>.

JDPower.com
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Gas Utility Residential


Home > Homes > Gas Utility Residential > MidWest

2007 Gas Utility Residential Customer Satisfaction Study

MidWest

| Company | Ratings Categories | | | | | |
|---|-------------------------------|---------------|---------------|---------------|-------------------|------------------|
| | Overall Customer Satisfaction | Company Image | Communication | Price & Value | Billing & Payment | Customer Service |
| MidAmerican Energy Award Recipient | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ |
| AmerenIP | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Aquila | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| CenterPoint Energy-Minnesota | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ |
| Citizens Gas & Coke Utility | ★★★★★ | ★★★★★ | ★★★★☆ | ★★★★★ | ★★★★★ | ★★★★★ |
| Columbia Gas of Ohio | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Consumers Energy | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Dominion East Ohio Gas | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Duke Energy | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| E.ON U.S. | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ |
| Kansas Gas Service | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Laclede Gas | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| MichCon | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Missouri Gas Energy | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Nicor Gas | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Northern Indiana Public Service Company | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Peoples Energy | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Vectren | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| We Energies | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Wisconsin Public Service | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |
| Xcel Energy-Midwest | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ | ★★★★☆ |

Scoring Legend
 ★★★★★ Among the best ★★★★ Better than most ★★★ About average ★★ The rest

Power Circle Ratings  [JDPower.com](#)

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1 In addition to analyzing the information we receive annually from J.D.
2 Power, we engage Market Strategies International ("MSI"), an energy research
3 and consulting firm, to conduct annual customer satisfaction surveys. MSI
4 performs separate surveys for residential customers and commercial and industrial
5 customers. MSI compares us to a peer group consisting of 17 natural gas and
6 combination electric and natural gas utilities located in the Midwest. The
7 residential study ranks each utility in 29 different categories and the commercial
8 and industrial study compares the utilities in 26 different categories. In both
9 surveys, Citizens Gas ranked number one in several categories.

10 While we are pleased with the rankings we have received from J.D. Power
11 as well as the results from the MSI surveys, the real value of those annual surveys
12 is the detailed information compiled about our customers' perceptions, which we
13 use to design programs and services that we hope will not only meet but exceed
14 customers' expectations.

15 Another strategy we believe leads to improved customer service is our
16 commitment to diversity. In January 2008, Citizens Gas was honored to accept
17 the Diversity Leadership Award from the Mayor of Indianapolis at the Seventh
18 Annual Mayor's Celebration of Diversity Awards Luncheon. In my view, in
19 order for Citizens Gas to truly understand the needs, priorities and perspectives of
20 our customers, our employees must represent the diversity of those customers.
21 We are committed to building and maintaining a workforce that reflects the
22 diversity of the community we serve.

1 **OVERVIEW OF RELIEF REQUESTED AND THE INSTANT PROCEEDING**

2 **Q. PLEASE GENERALLY DESCRIBE PETITIONER'S PRESENT RATES.**

3 A. Prior to this proceeding, Citizens Gas last filed for an increase to its base rates in
4 December 2004. In October 2006, the Commission issued an Order in that
5 proceeding approving a new schedule of rates designed to recover revenue
6 requirements based on a test year ending September 30, 2004. Prior to the
7 October 2006 Order, our base rates had not increased for 15 years. In August
8 2007, the Commission issued an order approving a settlement agreement between
9 Citizens Gas, the OUCC and a group of industrial intervenors, which resolved
10 certain issues that were pending on rehearing and appeal of the October 2006
11 Order. On September 1, 2007, Citizens Gas placed into effect rates in compliance
12 with the August 2007 Order, which were designed to recover the same overall
13 revenue requirement authorized in the October 2006 Order.

14 **Q. WHY IS CITIZENS GAS REQUESTING AN INCREASE TO ITS BASE**
15 **RATES FOR GAS UTILITY SERVICE?**

16 A. Given the nature of our organization, we are never pleased to request a rate
17 increase. As demonstrated by the other witnesses testifying on behalf of
18 Petitioner, however, the utility's current rates simply are not producing the
19 revenues we believe are needed for Citizens Gas to pay all the expenses of
20 operating the utility and maintain its utility property in a sound physical and
21 financial condition to render adequate and efficient service. In the three years
22 since the revenue requirement established in the last rate case was developed, the
23 overall costs incurred to operate and maintain the utility have risen. Ms. LaTona

1 Prentice's testimony addresses the *pro forma* revenue requirement that drives the
2 need for the rate increase requested in this case.

3 Unfortunately, certain attributes of our service territory worsen the upward
4 pressure on base rates. For example, over the last five years, Citizens Gas has
5 experienced a decrease in sales volume and at the same time a slight increase in
6 the number of customers it serves. While the decoupling mechanism approved by
7 the Commission helps ensure declining usage by customers does not erode the
8 utility's ability to recover its fixed costs as measured by the test year in the last
9 case, increases in costs will not be recovered absent an increase to the authorized
10 revenue requirement.

11 **Q. IN ADDITION TO A NEED FOR INCREASED REVENUES, IS CITIZENS**
12 **GAS FACING ANY OTHER MAJOR CHALLENGES THAT ARE**
13 **IMPORTANT IN THIS PROCEEDING?**

14 **A.** Yes. It has become increasingly difficult for Citizens Gas to maintain the high
15 credit ratings it has historically enjoyed. In October 2006, Standard & Poor's
16 Ratings Services ("S&P") lowered its rating on the utility's senior-lien gas utility
17 system bonds and first-lien gas utility distribution system bonds from A+ to A. In
18 November 2007, Moody's Investor Service ("Moody's") lowered its rating on the
19 second-lien gas utility distribution system bonds from Aa3 to A2.

20 Both S&P and Moody's emphasized two factors that affected their
21 decisions: (1) debt service coverage ratios; and (2) the time it takes to implement
22 increased rates after the Board has authorized management to seek the
23 Commission's approval of a rate increase. Moody's has been particularly

1 aggressive regarding the timing issue and has told us it benchmarks our ability to
2 implement rate increases against municipally-owned utilities that do not require
3 approval from a state utility regulatory agency in order to increase rates. While
4 we believe there are serious flaws in that comparison, which we have explained to
5 Moody's, that benchmark is the current reality for us.

6 As discussed by Mr. Brehm, based on recent positive regulatory
7 developments, S&P has upgraded the ratings on our debt. We remain concerned,
8 however, about the possibility of future downgrades, which we believe would
9 have serious financial ramifications for the utility and its customers.

10 Consequently, as discussed in more detail by Mr. Brehm, the time it takes to
11 conclude this proceeding and the outcome's effect on the utility's debt service
12 coverage ratios may have extremely important consequences for Citizens Gas and
13 its customers.

14 **Q. WHAT HAS CITIZENS GAS DONE TO ADDRESS THE CHALLENGE**
15 **YOU DESCRIBED ABOVE?**

16 **A.** First and foremost, we have attempted to make this case as straightforward and
17 uncontroversial as possible. We are seeking a relatively small base rate increase.
18 We have closely examined the Commission's October 2006 Order in Cause No.
19 42767 and eliminated certain items from this case's proposed revenue
20 requirement that were included in our proposed revenue requirement in that case.
21 For example, in this case, we have eliminated from the utility's proposed revenue
22 requirement all community investment costs, the vast majority of advertising

1 costs that were incurred during the test year and any request for cash working
2 capital.

3 We also are attempting to take advantage of lessons learned from our last
4 case. In addition to waiting too long to seek a base rate increase, our last case was
5 complicated by multiple requests for relief in addition to the requested increase to
6 our cash revenue requirement. While we are requesting in this case the ability to
7 recover the gas cost component of net write-offs through our gas cost recovery
8 mechanism and a change to our main extension policy, substantially similar
9 requests have been sought by other gas utilities and approved by the Commission
10 in recent cases. Finally, we are filing our petition and case-in-chief testimony at
11 the same time to reduce the appearance of regulatory lag that is created by filing a
12 petition in advance of the petitioner's case-in-chief.

13 **Q. IS CITIZENS GAS WILLING TO WORK WITH THE OUCC AND**
14 **INTERVENORS IN AN ATTEMPT TO RESOLVE THIS PROCEEDING**
15 **EXPEDITIOUSLY?**

16 **A.** Of course. We are optimistic a settlement can be reached. We applaud the
17 Commission's efforts to encourage parties to work together to arrive at mutually
18 acceptable solutions and avoid unnecessary litigation. We also very much
19 appreciate the OUCC's and industrial intervenors' willingness to work with us to
20 settle recent cases. The OUCC and industrial intervenors were, of course,
21 instrumental in the settlement reached in Cause No. 42767, which authorized
22 Citizens Gas to implement a much needed decoupling mechanism. The OUCC
23 also was very helpful in assisting Citizens Gas regarding the implementation of a

1 normal temperature adjustment ("NTA"). Both the decoupling mechanism and
2 the NTA were critically important developments and were looked favorably upon
3 by the credit rating agencies. Additionally, our sister steam utility, Citizens
4 Thermal Energy, recently reached a settlement agreement with the OUCC and
5 industrial intervenors in its general rate case, which led to a final order in a time
6 frame viewed as favorable by the credit rating agencies. Citizens Gas hopes to
7 build on those recent successes and achieve a settlement that would lead to an
8 expedited resolution of this case. We cannot rely exclusively on a settlement,
9 however, and will do our part to ensure the case, even if fully litigated, is resolved
10 in a time frame that will enhance our standing with credit rating agencies.

11 **Q. WHAT OTHER STEPS DOES CITIZENS GAS PLAN TO TAKE TO**
12 **ADDRESS THE CREDIT RATING CHALLENGE YOU DESCRIBED**
13 **ABOVE?**

14 **A.** We will continue our attempts to demonstrate to the credit rating agencies that the
15 time it took to complete our last gas rate case was an anomaly and the time frame
16 of Citizens Thermal Energy's recent steam rate case is representative of what they
17 should expect in the future.

18 Additionally, we have rethought our strategy regarding the frequency of
19 general rate cases, which we believe will help to some degree. As discussed
20 above, prior to Cause No. 42767, Citizens Gas had not sought an increase to its
21 base rates for over a decade. We focused exclusively on process improvements
22 and cost reductions as a means of managing our revenue requirement during that
23 period. We are proud of the accomplishments we made and the fact we were able

1 to postpone the need for a general rate increase for such an extended period of
2 time, but based on the current credit climate and other prevailing circumstances,
3 we intend to seek more frequent updates to our base rates. Our financial forecasts
4 also show the need for small, regular base rate increases, which we currently
5 anticipate will be sought approximately every three years. We believe more
6 frequent updates to our base rates will not only benefit Citizens Gas, but will
7 provide benefits to other stakeholders as well.

8 **Q. WHAT ARE THOSE BENEFITS?**

9 A. More frequent rate case filings will result in much simpler and more manageable
10 cases, which will not only benefit Citizens Gas but also will benefit the
11 Commission, the OUCC and intervening parties. Second, more frequent updates
12 to our rates will provide the Commission, the OUCC and other interested parties
13 more frequent opportunities to review our costs and increase the transparency of
14 our costs and prices. I want to emphasize that more frequent updates to our rates
15 will not result in any less of an effort to hold down costs. Third, smaller increases
16 are consistent with the principles of gradualism and will allow customers to better
17 manage their energy budgets. And finally, more frequent rate case filings will
18 reduce the likelihood of Citizens Gas under-earning and enhance the utility's
19 ability to maintain its credit rating.

1 **BOARD AUTHORIZATION OF PETITION**

2 **Q. PLEASE DESCRIBE THE POWERS OF THE BOARD AS THEY**
3 **RELATE TO THIS PROCEEDING.**

4 A. Pursuant to Indiana Code Section 8-1-11.1-3(c)(9), the Board is empowered to
5 adopt rates and rules for the utility services Citizens Gas provides its customers,
6 however, new rates and rules can only take effect after they have been approved
7 by this Commission and only after determining the rates are compliant with
8 Indiana Code Section 8-1.5-3-8.

9 **Q. HAS THE BOARD AUTHORIZED CITIZENS GAS TO FILE THE**
10 **PETITION SEEKING COMMISSION APPROVAL OF THE REVISED**
11 **RATES PROPOSED IN THIS PROCEEDING?**

12 A. Yes. On December 12, 2007, the Board adopted a Resolution authorizing and
13 directing that a petition requesting the relief we are seeking in this proceeding be
14 filed with the Commission by March 31, 2008. A certified copy of that Board
15 Resolution is attached to my testimony as Petitioner's Exhibit CBL-2. A certified
16 copy of the Board Resolution approving the proposed rates and terms and
17 conditions of service is attached hereto as Petitioner's Exhibit CBL-3.

18 **Q. PLEASE IDENTIFY PETITIONER'S EXHIBIT CBL-4.**

19 A. Petitioner's Exhibit CBL-4 consists of the legal notices published in connection
20 with the requested rate increase and other relief requested in this proceeding.

1 CONCLUSION

2 Q. PLEASE INTRODUCE THE OTHER WITNESSES TESTIFYING ON
3 BEHALF OF CITIZENS GAS IN THIS PROCEEDING AND PROVIDE A
4 BRIEF OVERVIEW OF THEIR TESTIMONY.

5 A. In addition to me, the following witnesses are offering testimony in support of the
6 relief requested by Citizens Gas in this proceeding:

- 7 • Mr. John R. Brehm, Senior Vice President and Chief Financial Officer,
8 sponsors Petitioner's test year income statement and balance sheet, the *pro*
9 *forma* requirement for debt service and interest income and *pro forma*
10 adjustments to the amount of test year Corporate Support Services costs
11 allocated to Petitioner as a result of cessation of operations of the coke
12 manufacturing business. Mr. Brehm also discusses Citizens Gas's credit
13 rating and auction rate bond refinancing.
- 14 • Ms. LaTona S. Prentice, Executive Director of Regulatory Affairs, describes
15 Petitioner's overall revenue requirement, a proposed net write-off recovery
16 mechanism and a modification to the rules governing main extensions.
- 17 • Mr. Christopher H. Braun, General Manager of Gas Operations, testifies in
18 support of Petitioner's revenue requirement for extensions and replacements
19 and also discusses cost savings initiatives related to the operation of our gas
20 utility system.

- 1 • Mr. Craig A. Jones, Manager of Rates and Regulatory Affairs, sponsors
2 Petitioner's cost of service study as well as its proposed rate schedules and
3 terms and conditions of service.
- 4 • Mr. Russell A. Feingold, Vice President of Black & Veatch, also testifies in
5 support of certain aspects of Petitioner's cost of service study and the manner
6 in which Citizens Gas proposes to apportion its proposed revenue requirement
7 among its customer classes.
- 8 • Mr. Donald J. Clayton, Vice President of Management Consulting at Tangibl,
9 LLC, sponsors a depreciation study performed for Petitioner and the resulting
10 accrual depreciation rates.

11 **Q. DOES THAT CONCLUDE YOUR PREPARED DIRECT TESTIMONY?**

12 **A.** Yes, at this time.

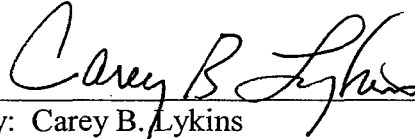
1
2 VERIFICATION
3

4 STATE OF INDIANA)

5) ss:

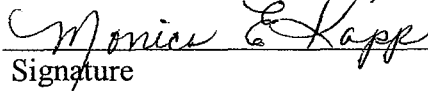
6 COUNTY OF MARION)
7

8 The undersigned, Carey B. Lykins, under penalties of perjury and being first duly
9 sworn on his oath, says that he is the President and Chief Executive Officer of
10 Citizens Gas & Coke Utility; that he caused to be prepared and read the foregoing
11 Direct Testimony; and that the representations set forth therein are true and correct to
12 the best of his knowledge, information and belief.
13

14
15 
16

17 By: Carey B. Lykins
18 President and Chief Executive Officer
19 Citizens Gas & Coke Utility
20

21
22 Subscribed and sworn to before me, a Notary Public, this 18 day of March, 2008.
23

24 
25 Signature

26
27 MONICA E. KAPP
28 Printed Name

29
30 My Commission Expires: Dec. 17, 2015
31

32 My County of Residence: Marion
33

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FILED

MAR 18 2008

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION
INDIANA UTILITY
REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS)
FOR UTILITIES OF THE DEPARTMENT OF)
PUBLIC UTILITIES OF THE CITY OF)
INDIANAPOLIS, AS SUCCESSOR TRUSTEE)
OF A PUBLIC CHARITABLE TRUST, D/B/A)
CITIZENS GAS & COKE UTILITY FOR (1))
AUTHORITY TO INCREASE ITS RATES AND)
CHARGES FOR GAS UTILITY SERVICE AND)
APPROVAL OF A NEW SCHEDULE OF)
RATES AND CHARGES APPLICABLE)
THERE TO, (2) AUTHORITY, TO THE EXTENT)
NECESSARY AS AN ALTERNATIVE)
REGULATORY PLAN, TO RECOVER THE GAS)
COST COMPONENT OF ITS NET WRITE-OFFS IN)
ITS GAS COST ADJUSTMENT FILINGS,)
(3) AUTHORITY PURSUANT TO 170 IAC 5-1-27(F))
FOR A NON-GAS COST REVENUE TEST TO)
DETERMINE WHEN DEPOSITS ARE REQUIRED)
FOR EXTENSION OF FACILITIES, (4) APPROVAL)
OF OTHER CHANGES TO ITS GENERAL TERMS)
AND CONDITIONS FOR GAS SERVICE, AND (5))
APPROVAL OF NEW DEPRECIATION ACCRUAL)
RATES)

4 3 4 6 3

CAUSE NO. _____

VERIFIED PETITION

The Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Gas & Coke Utility ("Petitioner"), respectfully petitions the Indiana Utility Regulatory Commission ("Commission") for: (i) authority to increase its rates and charges for gas utility service rendered by it and approval of a new schedule of rates and charges applicable thereto; (ii) authority, to the extent necessary as an alternative regulatory plan, to track the gas cost component of its net write-offs in its gas cost adjustment filings; (iii) authority pursuant to 170 IAC 5-1-27(F) for a non-gas cost

revenue test to determine when deposits are required for extension of facilities; (iv) approval of certain other changes to its general terms and conditions for gas service; and (v) approval of new depreciation accrual rates. In support of its Verified Petition, Petitioner states as follows:

Nature of Petitioner and Regulatory Status

1. Petitioner is the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Gas & Coke Utility. Its principal office is at 2020 North Meridian Street, Indianapolis, Indiana 46202. Petitioner distributes natural gas to the public, and provides gas delivery services to its eligible transportation customers. As of September 30, 2007, Petitioner provided gas service to approximately 258,974 residential, commercial, and industrial customers in and around Marion County, Indiana.

2. Petitioner provides adequate and efficient gas service to its customers by means of gas utility plant, properties, equipment and facilities owned, operated, managed and controlled by it, which are used and useful for the convenience of the public. Petitioner's gas plant includes, without limitation, transmission, distribution and liquefied natural gas storage facilities. Petitioner also owns underground natural gas storage facilities in Greene County, Indiana.

3. Pursuant to the terms of IC 8-1-11.1-3(a), Petitioner is charged by law with the duty of, and has all the necessary power and authority to furnish and sell services and products of, and to make all necessary construction, reconstruction, repairs, renewals, enlargements, extensions or additions to its plant and property, which in its judgment, are "desirable or necessary for the proper conduct of such business and the proper serving of the inhabitants of the city and adjacent, contiguous or suburban communities or territory" within Marion County, Indiana and adjacent areas.

4. Petitioner is a municipal gas utility as defined in IC 8-1-2-1(h) and an energy utility as defined in IC 8-1-2.5-2. Pursuant to IC 8-1-2.5-4, Petitioner elects to become subject to IC 8-1-2.5-5 and 6 to the extent that any of the relief requested herein is the subject of an alternative regulatory plan. Petitioner is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana, including certain provisions of the Public Service Commission Act, as amended.

5. Petitioner's rates and charges, and its terms and conditions for gas service, are subject to the approval of this Commission by virtue of the provisions of IC 8-1-11.1-3(c)(9). Pursuant to IC 8-1-11.1-3.1, Petitioner has all rights and powers conferred on a municipally owned utility and operates as both the board and the municipal legislative body for purposes of IC 8-1.5-3-8(e) and (f).

6. Under the provisions of IC 8-1.5-3-8, Petitioner is required by law to "furnish reasonably adequate services and facilities." Petitioner's gas utility system is properly maintained and is in satisfactory physical condition to render reasonably adequate service to its customers.

7. Pursuant to IC 8-1.5-3-8, rates and charges made by Petitioner for any service rendered or to be rendered, either directly or in connection therewith, "must be nondiscriminatory, reasonable, and just." Petitioner is obligated by law to maintain rates and charges for any service rendered by it to "produce an income sufficient to maintain the utility property in a sound physical and financial condition to render adequate and efficient service." IC 8-1.5-3-8(d). Petitioner's revenues and income from rates and charges for services need to be increased so that it can continue to operate and maintain its gas utility system in satisfactory physical and financial condition to render reasonably adequate service to its customers, and to

meet the requirements for reasonable and just rates and charges for services under IC 8-1.5-3-8(c), (d) and (e).

Petitioner's Present Rates and Charges

8. On October 23, 2006, Petitioner placed into effect a schedule of rates and charges designed to recover the revenue requirements the Commission approved in its October 19, 2006 Order in Cause No. 42767, based on a test year ending September 30, 2004. Petitioner's schedule of rates and charges also includes tracking factors which reflect: (i) charges for Variable Rate Supply Service, Back-up Supply Service, Usage Balancing Service, and Balancing (Rider A); (ii) charges for Supply of Last Resort Service, Basic Usage Balancing Service and Non-Performance (Rider B); (iii) funds made available from the non-regulated activities of Petitioner and its affiliates (Rider C); (iv) a normal temperature adjustment (Rider D); (v) an Energy Efficiency Adjustment for recovery of the cost of funding energy efficiency efforts and for reconciliation of the difference between Petitioner's actual margins and adjusted order granted margins (Rider E); and (vi) a Universal Service Fund Rider established by Order in consolidated Cause Nos. 43077 and 43078 (Rider F).

9. On March 5, 2007, Petitioner, the Indiana Office of the Utility Consumer Counselor and the Citizens Industrial Group filed a Settlement Agreement, which resolved certain issues that were pending on rehearing and appeal of the October 19, 2006 Order in Cause No. 42767. The Commission approved the terms of that Settlement Agreement by Order dated August 29, 2007. Petitioner filed its compliance rates and charges in accordance with said Order on August 31, 2007, and those rates and charges were placed into effect on September 1, 2007.

10. Petitioner's rates and charges for gas service, as approved by the Commission in Cause No. 42767, and as thereafter modified by the Order dated August 29, 2007 approving the

Settlement Agreement and by the tracking factors herein described, result in the collection of revenues which do not meet the requirements of reasonable and just rates and charges set forth in IC 8-1.5-3-8. Therefore, Petitioner's rates and charges are and will be too low and insufficient to:

(1) Pay all the legal and other necessary expenses incident to the operation of the utility, including:

- (A) Maintenance costs;
- (B) Operating charges;
- (C) Upkeep;
- (D) Repairs;
- (E) Depreciation; and
- (F) Interest charges on bonds or other obligations, including leases;

(2) Provide a sinking fund for the liquidation of bonds or other obligations, including leases;

(3) Provide a debt service reserve for bonds or other obligations, including leases, in an amount established by the [Board of Directors], not to exceed the maximum annual debt service on the bonds or obligations or the maximum annual lease rentals;

(4) Provide adequate money for working capital;

(5) Provide adequate money for making extensions and replacements to the extent not provided for through depreciation in subdivision (1); and

(6) Provide money for the payment of any taxes that may be assessed against the utility.

Accordingly, Petitioner's rates and charges presently in effect are unlawful under IC 8-1.5-3-8.

11. Petitioner's existing schedule of rates and charges needs to be further adjusted to reflect the results of a cost-of-service study.

12. Petitioner purchases gas for purposes of providing gas service to its customers. The cost of that gas is recovered through Petitioner's GCA mechanism. The GCA mechanism in

its current form determines the GCA charge by dividing Petitioner's gas costs by its sales volume. However, when customers do not, or cannot, pay their bills and Petitioner is not successful in its collection efforts, Petitioner must write-off the uncollected amount. Approximately 75% of Petitioner's net write-offs represents gas costs that have been incurred by Petitioner. When Petitioner's gas costs were more stable and lower in prior years, a representative level of net write-offs, including the gas cost component, was recovered in Petitioner's base rates. But, now gas costs are much higher and much more volatile than in the past. Therefore, Petitioner proposes to continue to recover through its base rates, the non-gas cost component of net write-offs at a fixed ratio of 0.8% of gas sales revenue; but requests Commission authorization (to the extent necessary as an alternative regulatory plan under IC 8-1-2.5-6) to recover in its quarterly GCA filings the gas cost component of net write-offs at a fixed ratio of 0.8% of total gas costs. Including a fixed portion of the gas cost component of net write-offs in the GCA mechanism is permitted by the GCA statute and is an accurate and appropriate way to recover these gas costs, especially given the very high and volatile market price for gas. Moreover, the proposed cost recovery mechanism will continue to provide an incentive for Petitioner to diligently manage its net write-offs. Petitioner's case-in-chief will include proposed GCA schedules designed to effectuate this proposed change. To the extent the foregoing request to include a fixed portion of the gas cost component of net write-offs in its GCA filings would require Commission approval under the terms of IC 8-1-2.5-6 as an alternative regulatory practice, procedure, mechanism, or plan, Petitioner hereby requests that the Commission provide any required approval in this proceeding.

Petitioner's Proposed Rates and Tariff Revisions

13. Petitioner proposes a number of revisions to its tariff for gas service that are described in its case-in-chief. By way of example, pursuant to 170 IAC 5-1-27(F), Petitioner requests that the Commission approve a change in the test for determining when a deposit is required for an extension of Petitioner's gas facilities from three years of total revenue to 5 ½ years of non-gas cost revenue.

14. Petitioner proposes, subject to the authorization and approval of this Commission, to cancel its existing schedule of rates and charges for gas service and to file with the Commission, in lieu thereof, a new schedule of rates and charges which will provide it with reasonable and just rates and charges for services within the meaning of IC 8-1.5-3-8. Petitioner's proposed schedule of rates and charges are based on an updated cost-of-service study, to better reflect the cost-of-service by customer class.

15. Petitioner's proposed revised schedule of rates and charges and terms and conditions of service will be accompanied by the prepared direct testimony and exhibits of Petitioner's witnesses and are being filed with the Commission simultaneously herewith.

Test Year

16. In accordance with 170 IAC 1-1.1-9(b), Petitioner proposes that the 12-month period ended September 30, 2007 be the test year fixed by the Commission, and that the cut-off date for adjustments that are reasonably known, fixed, and measurable, be within twelve months following the close of the test year.

New Depreciation Accrual Rates

17. Petitioner has caused to be prepared and will present a depreciation study as part of its case-in-chief. Petitioner requests Commission approval of revisions to its depreciation accrual rates for its gas utility plant in accordance with the results of that study.

Procedural Matters

18. Petitioner will publish notice to its customers of the filing of this Verified Petition and the requested upward adjustment to its rates and charges pursuant to IC 8-1-2-61 and IC 8-1-2.5-6(d). Petitioner will give its residential customers further notice of the precise extent of the requested rate adjustment (including the proposed new schedule of rates and charges) in accordance with 170 IAC 5-1-18(C).

19. Petitioner proposes that its new rates and charges be based upon its gas utility operations at September 30, 2007 and the results of its operations on an as-adjusted basis for the 12-month period after that date. Pursuant to 170 IAC 1-1.1-15(b) of the Commission's Rules of Practice and Procedure, Petitioner requests that the Commission convene a prehearing conference and preliminary hearing for the purposes of establishing a procedural schedule, resolving accounting, engineering, and such other matters as may properly come before the Commission in this proceeding.

20. The names and addresses of Petitioner's attorneys in this matter, to whom all correspondence and communications in this Cause should be sent, are:

Michael E. Allen (Atty. No. 20768-49)
Citizens Gas & Coke Utility
2020 N. Meridian Street
Indianapolis, IN 46202
Telephone: (317) 927-4318
Facsimile: (317) 927-4318
E-mail: mallen@cgcui.com

Michael B. Cracraft (Atty. No. 3416-49)
Steven W. Krohne (Atty. No. 20969-49)
Hackman Hulett & Cracraft, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030
Telephone: (317) 636-5401
Facsimile: (317) 686-3288
E-mail: mcracraft@hhclaw.com

Said attorneys are counsel for Petitioner and are duly authorized to accept service of papers in this Cause on behalf of Petitioner. In addition, papers filed in this proceeding should be served on LaTona S. Prentice, Executive Director of Regulatory Affairs, Citizens Gas & Coke Utility, 2020 N. Meridian Street, Indianapolis, Indiana 46202.

WHEREFORE, Citizens Gas respectfully requests that the Indiana Utility Regulatory Commission make an investigation and hold such hearings as it shall deem necessary and advisable in this proceeding and thereafter make and enter an Order in this Cause:

- (i) Finding that Petitioner's existing rates and charges for gas service are unjust, unreasonable, unlawful and inadequate to provide its annual requirements for funds for those items enumerated in IC 8-1.5-3-8;
- (ii) Determining, and by Order authorizing and approving just, reasonable, and sufficient rates and charges to be imposed by Petitioner in the future, in lieu of such present rates and charges;
- (iii) Authorizing Petitioner to recover the gas cost component of net write-offs in its quarterly GCA filings;
- (iv) Approving various changes in Petitioner's terms and conditions of service, including a variation from 170 IAC 5-1-27 to substitute a 5 ½ year non-gas cost revenue test for the 3-year total revenue test in determining when a deposit will be required for a facilities extension;
- (v) Authorizing Petitioner to revise the depreciation accrual rates applicable to its gas utility property in accordance with the depreciation study to be submitted as part of Petitioner's evidence in this proceeding;

- (vi) Authorizing and approving the filing of new schedules of rates and charges and terms and conditions of service applicable to the gas service rendered by Petitioner, embodying the just and reasonable rates and charges;
- (vii) Authorizing and approving additional requested changes to Petitioner's tariffs; and
- (viii) Granting such other and further relief as the Commission may deem necessary and appropriate in the premises.


DATED this 18th day of March, 2008.

BOARD OF DIRECTORS FOR UTILITIES OF
THE DEPARTMENT OF PUBLIC UTILITIES OF
THE CITY OF INDIANAPOLIS, AS
SUCCESSOR TRUSTEE OF A PUBLIC
CHARITABLE TRUST

By: Carey B. Lykins
Carey B. Lykins, President and Chief
Executive Officer

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

Carey B. Lykins, being first duly sworn upon oath, deposes and says that he is the President and Chief Executive Officer for the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Gas & Coke Utility, Petitioner in the above-entitled Cause; that as such he executed the foregoing Petition for and on behalf and in the name of said Board of Directors for Utilities, and has authority to do so; that he has read the foregoing Petition and is familiar with the contents thereof; and that the statements therein contained are true to the best of his knowledge, information and belief.



Carey B. Lykins, President and Chief
Executive Officer

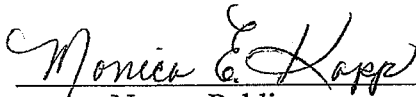
STATE OF INDIANA)
) SS:
COUNTY OF MARION)

Before me, a Notary Public in and for said County and State, personally appeared Carey B. Lykins who acknowledged the execution of the foregoing Petition.

Witness my hand and notarial seal this 18 day of March, 2008.

My Commission Expires:

Dec. 17, 2015



Notary Public
Printed: MONICA E KAPP
Resident of Marion County

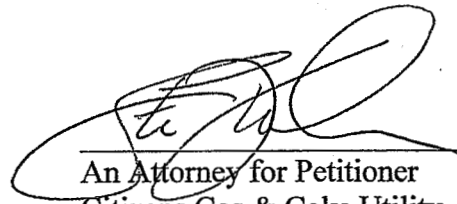
Michael E. Allen (Atty. No. 20768-49)
Citizens Gas & Coke Utility
2020 N. Meridian Street
Indianapolis, IN 46202

Michael B. Cracraft (Atty. No. 3416-49)
Steven W. Krohne (Atty. No. 20969-49)
Hackman Hulett & Cracraft, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030

Attorneys for Petitioner
Citizens Gas & Coke Utility

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing "Verified Petition" of the Board of Directors for Utilities was served on the Indiana Office of Utility Consumer Counselor by delivering a copy thereof to said office on this 18th day of March, 2008.


An Attorney for Petitioner
Citizens Gas & Coke Utility

Michael E. Allen (Atty. No. 20768-49)
Citizens Gas & Coke Utility
2020 N. Meridian Street
Indianapolis, IN 46202
Telephone: (317) 927-4318
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skrohne@hhclaw.com

Attorneys for Petitioner
Citizens Gas & Coke Utility

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

In Re: An excerpt from
The Regular Meeting held
December 12, 2007

VERIFIED CERTIFICATE OF RESOLUTION OF
THE BOARD OF DIRECTORS FOR UTILITIES
OF THE DEPARTMENT OF PUBLIC UTILITIES
OF THE CITY OF INDIANAPOLIS d/b/a
CITIZENS GAS & COKE UTILITY

The undersigned officer hereby certifies the following resolution was adopted by the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility on December 12, 2007, to-wit:

Mr. Lykins discussed with the Board the elements of a Petition management recommends be filed with the Indiana Utility Regulatory Commission ("Commission") to increase the Utility's rates and charges for service, and for approval of a new schedule of rates and charges for service, and for approval of certain changes to the terms and conditions of gas service. The Utility's current rates and charges for gas service were approved by the Commission in its Order in Cause No. 42767 issued on October 19, 2006, as modified by its Order on Rehearing issued on August 29, 2007. Mr. Lykins informed the Board that an analysis of the existing operating revenues from the Gas Division indicates that an increase to the Utility's rates and charges is necessary to ensure the Utility's rates and charges continue to produce sufficient revenues to meet the Utility's statutory revenue requirements. Based on a preliminary analysis of the pro forma revenue requirements for the test year ending September 30, 2007, Mr. Lykins indicated the proposed increase in annual gas operating revenues would range from between 3.5% to 4.0%, depending on the final results of pro forma adjustments to test year numbers. Mr. Lykins recommended that the Board authorize management to prepare and file on or before March 31, 2008, a Petition with the Commission seeking an increase in rates and charges for gas service,

approval of a new schedule of rates and charges for gas service and approval of certain changes to the Utility's terms and conditions of gas service. After discussion, the following Resolution was unanimously adopted:

RESOLVED by the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, that:

(1) The officers of the Utility are hereby authorized and directed, individually or jointly, to execute a Petition on behalf of the Board requesting an increase in the operating revenues produced by the Utility's rates and charges for gas service and approval of the other relief discussed at the Board meeting, and cause such Petition to be filed with the Commission on or before March 31, 2008;


(2) Management of the Utility is hereby authorized and directed to provide such public notice of the filing of the Petition as may be required by law or otherwise determined by them to be necessary or advisable;

(3) Management of the Utility also shall prepare such testimony and exhibits as necessary to support the relief requested in the Petition and take such other actions as they may determine to be advisable in order to successfully prosecute any proceedings on the Petition; and

(4) The proposed new schedule of rates and charges for gas service, terms and conditions of service and other materials comprising the requested relief in the general rate case shall be provided to the Board prior to filing with the Commission and will be subject to the review and approval of the Board as required by I.C. 8-1-11.1-3.1, I.C. 8-1-11.1-3(c)(9) and I.C. 8-1.5-3-8.

The undersigned officer of the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility, a municipal corporation of the State of Indiana duly authorized to do business pursuant to Indiana Code 8-1-11.1, hereby certifies that the foregoing is a full, true and correct copy of the resolution adopted by the Board of Directors for Utilities on December 12, 2007.

IN WITNESS WHEREOF, I have hereunto set my hand this 12th day of December 2007.

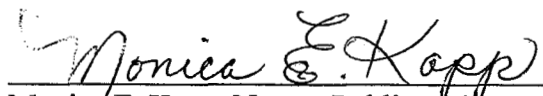


John R. Whitaker
Assistant Secretary

ACKNOWLEDGMENT

Before me appeared John R. Whitaker, to me personally known, who being by me duly sworn did affirm that he is the Assistant Secretary of the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility, a municipal corporation of the State of Indiana that has no corporate seal and that this certificate was made and executed by him for and on behalf of said Board by the authority vested in said Board pursuant to Indiana Code 8-1-11.1 as its free and voluntary act and deed.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal in Indianapolis, Indiana, this 12th day of December 2007.



Monica E. Kapp, Notary Public and
Resident of Marion County, State of Indiana

My Commission Expires:
December 17, 2015

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The materials comprising Petitioner's Exhibit CBL-3 are not yet available. These materials will be late-filed with the Commission as soon as possible and prior to the evidentiary hearing.

Proofs of publication of the legal notice are not yet available. Attached is a form of the legal notice that will be published. The proofs of publication that will comprise Petitioner's Exhibit CBL-4 will be late-filed with the Commission as soon as possible and prior to the evidentiary hearing.

**BEFORE THE INDIANA UTILITY
REGULATORY COMMISSION
CAUSE NO. 43463**

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS GAS & COKE UTILITY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR GAS UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (2) AUTHORITY, TO THE EXTENT NECESSARY AS AN ALTERNATIVE REGULATORY PLAN, TO RECOVER THE GAS COST COMPONENT OF ITS NET WRITE-OFFS IN ITS GAS COST ADJUSTMENT FILINGS, (3) AUTHORITY PURSUANT TO 170 IAC 5-1-27(F) FOR A NON-GAS COST REVENUE TEST TO DETERMINE WHEN DEPOSITS ARE REQUIRED FOR EXTENSION OF FACILITIES, (4) APPROVAL OF OTHER CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR GAS SERVICE, AND (5) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES

LEGAL NOTICE

PUBLIC NOTICE is hereby given that on March 18, 2008, the Board of Directors for Utilities ("Board") of the Department of Public Utilities of the City of Indianapolis filed with the Indiana Utility Regulatory Commission ("Commission") its verified petition requesting (i) authority to increase its rates and charges for gas utility service rendered by it and approval of a new schedule of rates and charges applicable thereto; (ii) authority, to the extent necessary as an alternative regulatory plan, to track the gas cost component of its net write-offs in its gas cost adjustment filings; (iii) authority pursuant to 170 IAC 5-1-27(F) for a non-gas cost revenue test to determine when deposits are required for extension of facilities; (iv) approval of certain other changes to its general terms and conditions for gas service; and (v) approval of new depreciation accrual rates. Pursuant to IC 8-1-11.1, the Board distributes to the public natural gas, and provides gas delivery service to eligible customers, in and near Marion County, Indiana under the tradename "Citizens Gas & Coke Utility." The Board will adopt, subject to the approval of the Commission, a new schedule of just and reasonable rates and charges consistent with the revenue requirement elements of IC 8-1.5-3-8. A copy of the Board's verified petition is on file with the Commission in Cause No. 43463 and details supporting the relief requested therein will be provided in the Board's testimony and exhibits to be filed with the Commission in Cause No. 43463.

Board of Directors for Utilities of the Department of
Public Utilities of the City of Indianapolis, d/b/a
Citizens Gas & Coke Utility

By: Carey B. Lykins,
 President and Chief Executive Officer

BEFORE THE
INDIANA UTILITY REGULATORY COMMISSION

| | | |
|--|---|------------------------|
| PETITION OF THE BOARD OF DIRECTORS |) | |
| FOR UTILITIES OF THE DEPARTMENT OF |) | |
| PUBLIC UTILITIES OF THE CITY OF |) | |
| INDIANAPOLIS, AS SUCCESSOR TRUSTEE |) | |
| OF A PUBLIC CHARITABLE TRUST, D/B/A |) | |
| CITIZENS GAS & COKE UTILITY FOR (1) |) | |
| AUTHORITY TO INCREASE ITS RATES AND |) | |
| CHARGES FOR GAS UTILITY SERVICE AND |) | CAUSE NO. 43463 |
| APPROVAL OF A NEW SCHEDULE OF |) | |
| RATES AND CHARGES APPLICABLE |) | |
| THERE TO, (2) AUTHORITY, TO THE EXTENT |) | |
| NECESSARY AS AN ALTERNATIVE |) | |
| REGULATORY PLAN, TO RECOVER THE GAS |) | |
| COST COMPONENT OF ITS NET WRITE-OFFS IN |) | |
| ITS GAS COST ADJUSTMENT FILINGS, |) | |
| (3) AUTHORITY PURSUANT TO 170 IAC 5-1-27(F) |) | |
| FOR A NON-GAS COST REVENUE TEST TO |) | |
| DETERMINE WHEN DEPOSITS ARE REQUIRED |) | |
| FOR EXTENSION OF FACILITIES, (4) APPROVAL |) | |
| OF OTHER CHANGES TO ITS GENERAL TERMS |) | |
| AND CONDITIONS FOR GAS SERVICE, AND (5) |) | |
| APPROVAL OF NEW DEPRECIATION ACCRUAL |) | |
| RATES |) | |

DIRECT TESTIMONY
of
JOHN R. BREHM

On
Behalf of
Petitioner
Citizens Gas & Coke Utility

Petitioner's Exhibit JRB

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is John R. Brehm. My business address is 2020 North Meridian Street,
3 Indianapolis, Indiana.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by the Board of Directors for Utilities (the "Board") of the
6 Department of Public Utilities of the City of Indianapolis (the "City"). The City
7 is the successor trustee of a public charitable trust and acting through the Board
8 manages and controls the municipally-owned utility that is the Petitioner in this
9 proceeding and does business as Citizens Gas & Coke Utility ("Petitioner or
10 "Citizens Gas"). I am Senior Vice President and Chief Financial Officer of the
11 municipal utilities managed and controlled by the Board, including Citizens Gas.

12 **Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AS**
13 **CHIEF FINANCIAL OFFICER OF CITIZENS GAS.**

14 A. As Chief Financial Officer, my duties include overall responsibility for
15 Petitioner's financial functions.

16 **Q. HOW LONG HAVE YOU BEEN EMPLOYED BY CITIZENS GAS?**

17 A. I have been employed by the Board since March of 2005.

18 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

19 A. I graduated from Indiana State University in 1975 with a degree of Bachelor of
20 Science in Accounting. I also am a Certified Public Accountant.

21 **Q. PLEASE DESCRIBE YOUR PRIOR BUSINESS EXPERIENCE.**

Direct Testimony and Exhibits of John R. Brehm
Petitioner's Exhibit JRB
Citizens Gas & Coke Utility
Page No. 2 of 35

1 A. I worked for Indianapolis Power & Light Company ("IPL") from June 1972
2 through March 2001, including the first three and one-half years as an accounting
3 co-op student. During my co-op period of employment, I engaged in various
4 accounting tasks in IPL's Financial and Special Reports Division. Upon my full
5 time employment with IPL in 1976, I worked consecutively as an accountant in
6 the Controller Organization and as a Financial Analyst in the Treasurer
7 Organization. From November 1978 to May 1980, I was Supervisor of the
8 Budget and Forecasting Division. From May 1980 to May 1981, I was Director,
9 General Accounting Department. In May 1981, I was elected Assistant Controller
10 of IPL where I was responsible to the Vice President and Controller for
11 overseeing the work customarily performed within an electric utility controller
12 function, including the preparation of internal and external financial statements,
13 tax returns, the annual operating budget, long-range financial forecasts and
14 accounting exhibits presented to regulatory bodies, including the Indiana Utility
15 Regulatory Commission ("Commission"). In 1987, I was elected Treasurer of
16 IPL. In that capacity, under the supervision of the Executive Vice President, I
17 was responsible for recommending, coordinating and implementing security
18 offerings, the daily cash management of funds including short-term borrowings
19 and short-term investments and other related treasury functions.

20 In April 1989, I was elected Senior Vice President – Financial Services of
21 IPL; in 1991 I was elected Senior Vice President – Finance and Information
22 Services of IPL; and in April 1998 I was elected Senior Vice President – Finance

1 of IPL. In those capacities, among other duties, I assisted in the formulation of
2 financial policy and directed and coordinated the financial and accounting
3 activities of IPL. I also directed the Controller and Treasurer in the performance
4 of their duties. I was responsible for coordinating, reviewing and approving all
5 major accounting and treasury changes, reports and financial strategies to
6 facilitate the financial management of IPL. I also supervised staff preparation for
7 registration, issuance and sale of securities. Additionally, I set policy and
8 supervised preparation for financial proceedings before all regulatory bodies,
9 including cases to establish basic rates and charges and fuel adjustment charge
10 proceedings that were presented before the Commission. In that capacity I
11 testified before the Commission on numerous occasions.

12 From April 1989 to March 2001, I also served as Vice President and
13 Treasurer of IPALCO Enterprises, Inc. ("IPALCO") and was the chief financial
14 officer ("CFO") of both IPALCO and IPL.

15 From April 2001 to June 2004, I worked as an independent utility
16 consultant providing professional services in a variety of areas, including
17 financial matters, regulatory matters and planning. In that capacity I testified
18 before the Commission as an expert witness.

19 From June 2004 through March 2005, I served as the Chief Operating
20 Officer of the Indiana Humanities Council, a nonprofit organization dedicated to
21 strengthening Indiana communities through targeted initiatives in leadership,
22 education and culture.

Direct Testimony and Exhibits of John R. Brehm
Petitioner's Exhibit JRB
Citizens Gas & Coke Utility
Page No. 4 of 35

1 Since becoming employed by the Board in March 2005, I have, among
2 other duties, served as the Senior Vice President and Chief Financial Officer of
3 Citizens Gas. In that capacity I assist in the formulation of financial policy and
4 direct and coordinate the financial and accounting activities of Citizens Gas. I
5 also direct the Controller, Treasurer and Director of Risk Management in the
6 performance of their duties. I am responsible for coordinating, reviewing and
7 approving all major accounting and treasury activities, reports and financial
8 strategies to facilitate the financial management of Citizens Gas. In that capacity,
9 I testified before the Commission in Cause No. 42767, the most recent Citizens
10 Gas rate case and I prefiled testimony in Cause No. 43201, the most recent rate
11 case of Thermal Energy, our sister steam utility.

12 **Q. WHAT HAVE YOU DONE TO PREPARE YOURSELF TO TESTIFY IN**
13 **THIS PROCEEDING?**

14 **A.** As Chief Financial Officer, I have ultimate responsibility for the Board's financial
15 statements, including the test year "Statement of Operations" or income statement
16 and "Statement of Financial Position" or balance sheet for Citizens Gas.
17 Throughout the test year in the normal course of preparing such statements, I met
18 with certain members of the accounting staff who are responsible for making
19 entries on the books and records, as well as those responsible for financial
20 statement preparation, in order to understand the data presented in the financial
21 statements. In addition, in the normal course of my duties, I have become
22 familiar with Petitioner's internal control procedures related to financial

1 statements. I have read the petition and the direct testimony and exhibits Citizens
2 Gas filed on March 18-19, 2008 in this proceeding. I have also familiarized
3 myself with certain parts of the statute that governs ratemaking for Citizens Gas.

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
5 **PROCEEDING?**

6 A. The purpose of my testimony is to provide support for and sponsor the test year
7 income statement and balance sheet for Citizens Gas. I also sponsor the pro
8 forma revenue requirement of Citizens Gas for debt service, as well as the amount
9 of its pro forma interest income. In addition, I sponsor the pro forma adjustments
10 to the test year allocation of Corporate Support Services costs to Citizens Gas
11 resulting from cessation of operations of the Manufacturing Division.

12 **TEST YEAR FINANCIAL STATEMENTS**

13 **Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-1.**

14 A. Petitioner's Exhibit JRB-1 is the Statement of Operations, or income statement,
15 for the twelve months ended September 30, 2007 (the test year for this
16 proceeding) for Citizens Gas. The operating income for Citizens Gas for the
17 twelve months ended September 30, 2007, as shown on line 8 of Exhibit JRB-1,
18 was \$14,241,741, and the net *loss* for Citizens Gas, as shown on line 11 of Exhibit
19 JRB-1, was \$3,440,404.

20 **Q. WERE ANY MATERIAL NON-RECURRING ITEMS OF REVENUE OR**
21 **EXPENSE RECORDED DURING THE TEST YEAR THAT MUST BE**

**ELIMINATED FROM THE TEST YEAR INCOME STATEMENT ON A
PRO FORMA BASIS?**

A. Yes, there were two such material non-recurring items recorded during the test year. During fiscal year 2007 (October 1, 2006 through September 30, 2007; also "the test year"), Citizens Gas recorded \$2,488,000 of income related to a weather hedge it established prior to the 2006/2007 winter heating season. Since weather during such heating season was milder than normal, the weather hedge paid off in our favor. However, this is a non-recurring item that must be eliminated from the test year income statement on a pro forma basis. It is not appropriate when establishing rates for gas service to assume that weather will be milder than normal; rather, it is appropriate to assume that weather will be normal. If weather is normal, then any weather hedge in place will not pay off in the utility's favor.

Another material non-recurring item recorded during the test year that must be eliminated from the test year income statement on a pro forma basis is a correcting adjustment that was made to accrued long-term incentive plan costs.

During fiscal year 2007 it was discovered through a reconciliation process that the liability account for long-term incentive plan costs was overstated by \$3,873,222 (Citizens Gas' portion of this was \$2,451,750). Such overstatement was the result of a misinterpretation of the intent of certain plan changes that occurred and were recorded in fiscal years prior to 2007. The overstatement was detected through

1 one of our company-level control procedures¹ and corrected before material
2 incorrect cash payments were made to employees covered by the plan. The
3 correcting entry was recorded in fiscal year 2007 and was accomplished through a
4 debit to the liability account to bring it to the correct amount and an offsetting
5 credit to an expense account. Consequently, such correcting entry had the effect
6 of reducing the amount of long-term incentive plan expense recorded in fiscal
7 year 2007. Since the adjustment to the expense account was to correct years prior
8 to the test year and is non-recurring, it must be eliminated from the test year
9 income statement on a pro forma basis.

10 Both of the aforementioned pro forma eliminations are included in the pro
11 forma adjustments sponsored by Petitioner's witness LaTona S. Prentice. Of
12 course, the pro forma adjustments Mrs. Prentice sponsors include not only these
13 eliminations of non-recurring items, but also going-level adjustments to certain
14 recurring items of revenue and expense, as well as adjustments to reflect new
15 items of revenue and expense that will be recurring.

16 **Q. HOW DID CITIZENS GAS RECORD COMMUNITY INVESTMENT,**
17 **ADVERTISING AND CUSTOMER RELATIONSHIP DEVELOPMENT**
18 **COSTS DURING THE TEST YEAR?**

19 **A.**During the test year, no community investment costs were recorded on the books
20 of Citizens Gas. This is consistent with the Commission's finding regarding such
21 costs in its Order in the last Citizens Gas rate case, Cause No. 42767, at page 25.

¹ A company-level control is a formal accounting term for a control performed at a higher level and in a

1 Such costs were funded with cash from non-regulated businesses owned directly
2 and indirectly by the Board.

3 Additionally, 15% of Citizens Gas' advertising costs were recorded on the
4 books of Citizens Gas consistent with the finding in Cause No. 42767 at page 34
5 of the Order that such percentage of the Utility's advertising costs was for the
6 purposes of providing customers with safety, conservation or service information.

7 The remaining 85% of advertising costs were not recorded on the books of
8 Citizens Gas, as they were funded with cash from non-regulated businesses
9 owned directly and indirectly by the Board. This is consistent with the
10 Commission finding at page 35 of its Order in Cause No. 42767. Finally, 50% of
11 Citizens Gas' customer relationship development costs also were not recorded on
12 the books of Citizens Gas and instead were funded with cash from non-regulated
13 businesses. This is consistent with the Commission finding at page 39 of its
14 Order in Cause No. 42767.

15 **Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-2.**

16 A. Petitioner's Exhibit JRB-2 is the Statement of Financial Position, or balance
17 sheet, as of the last day of the test year, September 30, 2007.

18 The total assets of Citizens Gas at September 30, 2007, as shown on line
19 22, were \$515,288,826.

20 It is important to note the nature of the funds shown on lines 6 and 7 of
21 Exhibit JRB-2. These funds are designated as *restricted* because, by the terms of

different time frame than when a transaction is recorded.

1 Petitioner's bond indentures, they are reserved for servicing long-term debt.
2 Therefore, those funds are not available for use in meeting the general revenue
3 requirements of Citizens Gas. Under the provisions of the bond trust indentures,
4 Citizens Gas is required to make monthly payments into these principal and
5 interest deposit accounts from Petitioner's general fund to accumulate cash over a
6 six month period to be subsequently paid to the bond trustee for debt service
7 payments to the bondholders.

8 The capital structure of Citizens Gas at September 30, 2007 includes
9 outstanding long-term debt of \$328,450,000, current maturities of long-term debt
10 of \$9,175,000, tax-exempt commercial paper (which is outstanding at all times) of
11 \$50,000,000 and retained earnings (including accumulated other comprehensive
12 loss) of \$33,324,523.

13 **Q. HAVE THE AMOUNTS PRESENTED IN PETITIONER'S EXHIBITS**
14 **JRB-1 AND JRB-2 BEEN SUBJECTED TO AUDIT BY AN**
15 **INDEPENDENT FIRM OF CERTIFIED PUBLIC ACCOUNTANTS?**

16 **A.** Yes. The amounts presented in Petitioner's Exhibits JRB-1 and JRB-2 are
17 included in footnote 10 of Petitioner's consolidated financial statements, which
18 were audited by the international certified public accounting firm of
19 PricewaterhouseCoopers ("PwC"). The footnotes are considered an integral part
20 of the financial statements upon which an independent auditor expresses an
21 opinion. PwC issued an unqualified opinion on Petitioner's consolidated financial
22 statements.

DEBT SERVICE AND INTEREST INCOME

**Q. WHAT WAS THE TOTAL PRINCIPAL AMOUNT OF THE
OUTSTANDING DEBT OF CITIZENS GAS AT SEPTEMBER 30, 2007, AS
PRESENTED ON THE BALANCE SHEET IN PETITIONER'S EXHIBIT
JRB-2?**

A. The total principal amount of the outstanding debt of Citizens Gas at September 30, 2007 was \$387,625,000. As described in the previous section of my testimony, that amount was made up of long-term debt in the amount of \$328,450,000, current maturities of long-term debt in the amount of \$9,175,000 and tax-exempt commercial paper (which is outstanding at all times) of \$50,000,000.

Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-3.

A. Petitioner's Exhibit JRB-3 presents actual test year debt service, as well as pro forma debt service on the Gas Utility System bonds and the Gas Utility Distribution System bonds, commercial paper, bank line of credit, interest on customer deposits and debt portfolio administration expenses. Petitioner's Exhibit JRB-3, column E, line 11 shows the total test year debt service for Citizens Gas was \$26,908,391.

**Q. HAS THE INDIANA UTILITY REGULATORY COMMISSION
("COMMISSION") FOUND THAT DEBT SERVICE ON THE SPECIFIC
ITEMS IDENTIFIED IN PETITIONER'S EXHIBIT JRB-3 AS DEBT**

1 **OUTSTANDING AT SEPTEMBER 30, 2007 IS ENTIRELY ALLOCABLE**
2 **TO CITIZENS GAS?**

3 A. Yes. The Commission made such a finding at page 57 of its Order in Cause No.
4 42767, the Utility's most recent gas rate case:

5 In the 1991 rate order, we determined that there was no "basis for
6 allocating any of the debt service between Petitioner's
7 divisions..."...we similarly find today that Citizens indebtedness
8 should not be allocated to its other divisions. Such a finding is
9 consistent with the treatment of this indebtedness by Standard &
10 Poor's, and a contrary finding would have serious ramifications on
11 Citizens' creditworthiness. Moreover, the only bonds that could be
12 subject to allocation are the GUS bonds, which were last issued in
13 1986 and considered in the 1991 order to be attributed to the Gas
14 Division. The remaining GUDS bonds are solely for the purpose
15 of financing the gas distribution system. Accordingly, we reject
16 the OUCC's and CIG's proposed adjustments to debt service, and
17 find that 100 percent of Citizens debt service properly allocated to
18 the Gas Division.
19

20 **Q. PLEASE DESCRIBE THE PRO FORMA DEBT SERVICE AMOUNTS**
21 **SUMMARIZED UNDER COLUMN I OF EXHIBIT JRB-3.**

22 A. The Pro Forma debt service of \$29,498,396 includes interest at the stated fixed
23 rate on the Series 1986B Gas Utility System bonds and the required fiscal year
24 2008 principal payment and interest at the stated fixed rates on the Series 1998A
25 Gas Utility Distribution System ("GUDS") bonds.

26 Pro forma debt service on the variable-rate Tax-Exempt Commercial
27 Paper and bank line of credit is the average of the actual interest paid on such debt
28 during the three years ended September 30, 2007. It is appropriate to use a 3-year
29 average of interest paid on such debt because Citizens Gas plans to file a rate case

1 approximately every 3 years, as described in the testimony of Mr. Lykins.
2 Consequently, consistent use from rate case to rate case of the 3-year average
3 methodology for computing pro forma interest on variable rate debt will, over
4 time, allow the amount of debt service Citizens Gas actually experiences on its
5 floating rate debt to be accurately reflected in the rates Citizens Gas charges
6 customers for gas service. The amount in the other cost column for the Tax-
7 Exempt Commercial Paper includes the fee for the bank letter of credit that stands
8 behind the commercial paper to provide the marketplace necessary assurance of
9 liquidity and the brokerage fees paid for remarketing the commercial paper each
10 time a tranche comes due. The amount in the other cost column for the bank line
11 of credit is the annual commitment fee. I used the actual test year amounts of
12 other costs as the pro forma amount of other costs related to the commercial paper
13 and the bank line.

14 Pro forma interest on customer deposits is the product of multiplying the
15 13-month average of customer deposit balances outstanding during the test year
16 times the customer deposit interest rate for 2008 of 3.5% published by the
17 Commission.

18 The other debt portfolio administration expenses shown on line 10 of
19 Petitioner's Exhibit JRB-3 include bond trustee fees and annual monitoring fees
20 paid to the rating agencies.

21 In addition, the pro forma debt service includes estimated debt service on
22 two new series of bonds, the Series 2008A and Series 2008B bonds, which

1 Citizens Gas plans to issue in March and April 2008, respectively, to refinance the
2 Series 2001 and Series 2003A Gas Utility Distribution System bonds.

3 **Q. WHY IS CITIZENS GAS REFINANCING THE SERIES 2001 AND**
4 **SERIES 2003A BONDS?**

5 A. When Citizens Gas issued those bonds, it utilized the variable-rate auction rate
6 mode to establish the interest rate on each Series. This ensured its debt portfolio
7 would include an amount of long-term insured, tax-exempt debt that took
8 advantage of the short end of the yield curve by resetting interest rates every 7
9 days at a rate determined through an auction conducted by a third-party broker-
10 dealer and auction agent. Use of this debt instrument provided diversification of
11 interest rate risk and reduced borrowing costs significantly. From the dates the
12 bonds were issued through January 2008, Citizens Gas experienced weekly
13 auction rates ranging from less than 1% to 3.95%.

14 Auction rate notes are in widespread use across the spectrum of municipal
15 debt issuers. For example, a partial list of notable auction rate issuers in Indiana
16 includes Duke Energy, Vectren, the State of Indiana and Indianapolis Waterworks
17 (while not all of these entities are municipal entities, they have issued auction rate
18 notes that qualify as municipal debt). Unfortunately, however, credit concerns
19 regarding the bond insurers, including the insurer of Citizens Gas' auction rate
20 debt, began to emerge in late 2007 due to the theretofore unknown credit exposure
21 that insurers had to the sub-prime mortgage crisis that has been well-publicized in
22 both the financial and popular press. As a result, several of the primary bond

1 insurers were downgraded from AAA ratings in early 2008. Citizens Gas'
2 auction rate notes were insured by Ambac Assurance Corporation, whose long-
3 term credit rating was downgraded from AAA to AA by Fitch on January 18,
4 2008.

5 As a result of actual and rumored insurer downgrades, investor
6 participation in the auction rate market dropped precipitously and auctions across
7 the country began to fail in their weekly remarketing of bonds offered for sale.
8 When bonds that are offered for sale do not receive sufficient clearing bids, the
9 holders of those securities are required to continue holding those bonds at interest
10 rates determined through a formula prescribed in the offering documents. These
11 rates are generally higher than comparable tax-exempt money market rates in
12 order to compensate the investors for holding securities they no longer desire to
13 hold. As a protective measure for issuers, the offering documents also include
14 maximum rates at which the bonds can pay interest.

15 Citizens Gas experienced failed auctions on its Gas Utility Distribution
16 System Series 2001 and Series 2003A bonds beginning with the February 15,
17 2008 auction. Since the beginning of fiscal year 2008, the auction rate notes were
18 experiencing weekly reset rates between 3.50% and 3.90%. However, since
19 February 15, 2008 the weekly rates have reset between 5.40% and 8.75%.

20 We believe the auction rate market may be permanently impaired and
21 have developed a plan to refund the Series 2001 and Series 2003A bonds with
22 Series 2008A and Series 2008B Gas Utility Distribution System bonds.

1 **Q. PLEASE DESCRIBE CITIZENS GAS' REFUNDING PLAN WITH**
2 **RESPECT TO THE SERIES 2001 GAS UTILITY DISTRIBUTION**
3 **SYSTEM BONDS AND SERIES 2003A GAS UTILITY DISTRIBUTION**
4 **SYSTEM BONDS.**

5 A. Petitioner's Exhibit JRB-4 is a background paper on this subject I prepared and
6 sent to the Board on March 6, 2008 and discussed with the Board at its special
7 meeting regarding this subject on March 11, 2008. The refunding plan with
8 respect to the Series 2001 GUDS bonds is described in Petitioner's Exhibit JRB-4
9 under the subheading "Refunding Plan" beginning on page 2 and continuing to
10 the middle of page 3. The refunding plan with respect to the Series 2003A GUDS
11 bonds is also described on Petitioner's Exhibit JRB-4 beginning on the middle of
12 page 3 and continuing to the end.

13 **Q. PLEASE DESCRIBE THE PRO FORMA DEBT SERVICE ON THE 2008A**
14 **BONDS THAT REFUND THE SERIES 2001 BONDS, AS SUMMARIZED**
15 **UNDER COLUMNS G AND I ON LINE 4 OF PETITIONER'S EXHIBIT**
16 **JRB-3.**

17 A. Petitioner's Exhibit JRB-3 assumes the Series 2008A bonds will be issued as
18 long-term uninsured, fixed-rate bonds with maturities matching the original
19 maturity dates of the Series 2001 bonds. The assumed principal amount of the
20 Series 2008A bonds is \$113,375,000 which includes sufficient funds to refund
21 both the Series 2001 bonds and \$10 million of outstanding bank debt, plus cover
22 the cost of issuance of the Series 2008A bonds. The Series 2008A bonds are

1 assumed to pay interest at a fixed-rate of 5.75%. Consequently, total debt service
2 on these bonds is estimated to be \$6,519,062.

3 **Q. PLEASE DESCRIBE THE PRO FORMA DEBT SERVICE ON THE**
4 **SERIES 2008B BONDS THAT REFUND THE SERIES 2003A BONDS, AS**
5 **SUMMARIZED UNDER COLUMNS F, G, H AND I ON LINE 6 OF**
6 **PETITIONER'S EXHIBIT JRB-3.**

7 A. Petitioner's Exhibit JRB-3 assumes the Series 2008B bonds will be issued as
8 Variable Rate Demand Bonds ("VRDBs")² with maturities matching the original
9 maturity dates of the Series 2003A bonds. The assumed principal amount of the
10 Series 2008B bonds is \$69,300,000, which includes sufficient funds to refund the
11 Series 2003 bonds plus cover the cost of issuance of the Series 2008B bonds. The
12 assumed principal payment on the Series 2008B bonds is identical to the principal
13 payment that was scheduled on the Series 2003A bonds. The Series 2008B bonds
14 are assumed to pay interest at a floating rate that over time averages 70% of
15 LIBOR. That means our assumption is that the two floating legs of the interest
16 rate swap³ perfectly offset one another and results in an effective fixed rate on the
17 Series 2008B bonds of 4.59%. The other costs summarized under column H of
18 line 6 assume an annual bank letter of credit fee of 65 basis points and an annual
19 remarketing fee of 8 basis points. Consequently, total debt service on these bonds
20 is estimated to be \$5,546,760.

² VRDBs are described in Petitioner's Exhibit JRB-4 beginning in the middle of page 3 of such Exhibit.

³ The interest rate swap is described in Petitioner's Exhibit JRB-4, beginning in the middle of page 3.

1 In making the assumption the Series 2008B bonds will pay interest at a
2 floating rate that over time averages 70% of LIBOR there is substantial risk to
3 Citizens Gas that the annual revenue requirements for debt service based on this
4 assumption will be at least \$500,000 lower than its actual annual debt service
5 cost. This is because VRDB's are currently paying interest at approximately
6 100% of LIBOR and there is no guarantee they will return to the 70% of LIBOR
7 historical average.

8 **Q. PETITIONER'S EXHIBIT JRB-3 SETS FORTH THE TOTAL PRO**
9 **FORMA DEBT SERVICE AMOUNT, INCLUDING THE ESTIMATED**
10 **ANNUAL DEBT SERVICE ON BONDS THAT WILL BE ISSUED AFTER**
11 **YOUR PREPARED DIRECT TESTIMONY AND EXHIBITS ARE FILED.**
12 **WHAT INFORMATION DO YOU PLAN TO PROVIDE THE**
13 **COMMISSION AND THE OTHER PARTIES FOLLOWING THE**
14 **ISSUANCE OF THE SERIES 2008A AND 2008B BONDS?**

15 **A.** To the extent that the actual debt service on the 2008A and 2008B bonds differs
16 from the estimated debt service that is set forth in Petitioner's Exhibit JRB-3, we
17 will file with the Commission a notice of corrections, which will update any
18 numbers to reflect that difference.

19 **Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-5.**

20 **A.** Petitioner's Exhibit JRB-5 calculates the \$2,361,245 of pro forma interest income
21 by computing the average of actual interest income earned on cash investments
22 during the three years ended September 30, 2007. Citizens Gas typically has cash

1 reserves invested in money market securities and/or fixed-income securities, and
2 also earns interest income on cash it is required to deposit in advance of required
3 payments for debt principal and interest. The amount of cash reserves available
4 for investment fluctuates widely from year-to-year and from season-to-season
5 within any year based on numerous factors including, but not limited to, the
6 market price of natural gas that Citizens Gas must buy in advance of distributing
7 such gas to customers, customer payment patterns and the amount of gas
8 withdrawn from storage during the heating season that must be replenished prior
9 to the next heating season. In addition, the interest rate Citizens Gas earns on
10 investments fluctuates with the market. Given these realities, it is appropriate to
11 use a 3-year average of interest income earned on cash investments because
12 Citizens Gas plans to file a rate case approximately every 3 years (see the
13 testimony of Mr. Lykins). Consequently, consistent use from rate case to rate
14 case of the 3-year average methodology for computing pro forma interest income
15 on cash investments will over time allow the amount of interest income Citizens
16 Gas actually experiences on its cash investments to be accurately reflected in the
17 rates Citizens Gas charges customers for gas service.

18 **Q. HAVE YOU CALCULATED THE DEBT SERVICE COVERAGE RATIO**
19 **FOR CITIZENS GAS?**

20 A. Yes. Petitioner's Exhibit JRB-6 is a computation of Citizens Gas' debt service
21 coverage ratio on an actual basis for fiscal years 2006 and 2007 and on a pro
22 forma basis at present rates and at the proposed rates and charges for gas service

1 requested in this case. Following fiscal year 2006 when Citizens Gas experienced
2 a coverage ratio of less than 1.0, both Standard & Poor's and Moody's lowered
3 Citizens Gas' credit rating on its second lien bonds, which effectively is the only
4 lien it can currently use to issue new debt, to single A (Standard & Poor's, A;
5 Moody's, A2). This occurred in spite of the fact that Citizens Gas received a rate
6 increase in late 2006 that resulted in an improved coverage ratio in fiscal year
7 2007. In cutting Citizens Gas' credit rating both Moody's and Standard & Poor's
8 cited the fact that Citizens Gas' coverage ratio fell below 1.0 in fiscal year 2006.

9 **Q. HAVE YOU HAD ANY RECENT DISCUSSIONS WITH THE RATINGS**
10 **AGENCIES REGARDING CITIZENS GAS' CREDIT RATING?**

11 A. Yes. As part of the aforementioned refunding of the Series 2001 and Series
12 2003A Gas Utility Distribution System bonds, Citizens Gas requested ratings
13 from Moody's and Standard & Poor's on the Series 2008A and Series 2008B
14 refunding issues.

15 On March 17, 2008, Standard & Poor's upgraded our credit rating on first
16 lien and second lien GUDS bonds (the Series 2008A and Series 200B bonds will
17 be second lien GUDS bonds) to A+. The Commission's approval in 2007 of the
18 Normal Temperature Adjustment and Energy Efficiency Adjustment (decoupling)
19 mechanisms, the improved cash flow⁴ Citizens Gas experienced in fiscal year
20 2007 and projected further improvement following this rate case were listed as
21 credit strengths in the ratings report. Additionally, the Standard & Poor's analyst

⁴ Rating agencies use the terms "cash flow" and "debt service coverage" relatively interchangeably.

1 informed me that the Commission's timely resolution in 2007 of Citizens Thermal
2 Energy's steam utility rate case was a factor in the upgrade decision. The analyst
3 also informed me there was a substantial debate among the members of their
4 rating committee regarding their qualitative opinion of the Indiana regulatory
5 environment and stated that an outcome in this rate case that Standard & Poor's
6 judged to be adverse could once again bring our credit rating under pressure.

7 As of this writing, we have not yet received Moody's decision regarding
8 the Series 2008A and Series 2008B refunding issues.

9 **Q. PLEASE EXPLAIN THE IMPLICATIONS OF CITIZENS GAS' PRO**
10 **FORMA DEBT SERVICE COVERAGE RATIO AT PRESENT RATES.**

11 A. Petitioner's Exhibit JRB-6 shows Citizens Gas' pro forma debt service coverage
12 ratio at present rates moves precariously toward the 1.0 level, which is an
13 outcome that must be reversed for Citizens Gas to be able to sustain its current
14 credit rating as our credit rating was cut the last time we fell below a debt service
15 coverage ratio of 1.0. A reduction in Citizens Gas' credit rating would be onerous
16 for the utility and its customers and could place us in a situation that cuts the
17 utility off from accessing important sources of funding. The reduction of Citizens
18 Gas' credit rating to single A effectively eliminated any margin of safety in our
19 credit position⁵. For example, if Citizens Gas' credit rating fell to BBB+, it is
20 unlikely we would be able to secure an irrevocable letter of credit from a bank in
21 today's challenging credit market. That would make it impossible for us to issue

⁵ The current Moody's rating of A2 is the equivalent of single A.

1 VRDBs as described above. In addition, it would jeopardize our outstanding \$50
2 million of tax-exempt commercial paper, as having an irrevocable letter of credit
3 in place is a necessary prerequisite to sustaining a tax-exempt commercial paper
4 program. Also, falling to BBB+ would likely force Citizens Gas to agree to more
5 restrictive covenants with respect to issuing new debt and with respect to periodic
6 renewals of its bank facilities. More restrictive covenants translate directly into a
7 higher cost of debt and increased revenue requirements. Moreover, in the current
8 market, if Citizens Gas had a BBB+ credit rating the interest rate it would pay on
9 the refunding debt it will be issuing would be at least 50 basis points higher.

10 **Q. PETITIONER'S EXHIBIT JRB-6 SHOWS CITIZENS GAS' PRO FORMA**
11 **DEBT SERVICE COVERAGE RATIO AT PROPOSED RATES TO BE**
12 **1.85. IS THE PROPOSED REVENUE REQUIREMENT DESIGNED TO**
13 **ACHIEVE THAT COVERAGE RATIO?**

14 A. No. The proposed rate increase is designed to produce revenues sufficient to
15 satisfy the cash revenue requirement formula set forth in the municipal
16 ratemaking statute, which includes revenues we believe are needed to fund the
17 ongoing extensions and replacements that Mr. Braun discusses in his prepared
18 testimony. The debt service coverage ratio is simply a mathematical result based
19 on that revenue requirement. Importantly, the debt service coverage ratio is
20 computed without taking into consideration any expenditure for extensions and
21 replacements. In other words, as the table below shows, when extensions and
22 replacements are taken into consideration, a debt service coverage ratio of 1.85

1 would result in Citizens Gas achieving a net cash flow of zero, after paying for
2 extensions and replacements and debt service.

| | |
|--|-------------------|
| Operating Income | \$31,603,447 |
| Depreciation and Amortization | 19,528,332 |
| Other Income and Deductions | <u>1,231,515</u> |
| Earnings Before Interest, Depreciation and Amortization | 52,363,294 |
| Debt Service | 28,368,666 |
| Extensions and Replacements | <u>23,994,628</u> |
| Net Cash Flow | \$0 |

3
4 As the table above demonstrates, any coverage ratio below 1.85 would result in a
5 continuation of negative cash flow at Citizens Gas. Thus, while the revenue
6 requirement we have proposed would result in a debt service coverage ratio that
7 will be viewed favorably by the rating agencies and solidify our current credit
8 rating, it is designed to produce only the revenues we believe are needed to pay
9 the necessary expenses incident to operation of the utility.

10 **CORPORATE SUPPORT SERVICES**

11 **Q. TURNING TO A NEW SUBJECT, WHAT IS CORPORATE SUPPORT**
12 **SERVICES?**

13 **A.** We have organized our executive management and administrative functions as
14 well as certain billing and customer service functions within a centralized
15 Corporate Support Services or "CSS" organizational framework. This centralized
16 organizational framework includes the following departments: Executive,
17 Finance, Treasury, Human Resources, Legal, Corporate Affairs, Risk
18 Management, Internal Audit, Regulatory Affairs, Marketing, Security, Billing,
19 Customer Relations, Information Services, Environmental Affairs, Safety,

1 Procurement and Building Maintenance. By centralizing these functions, Citizens
2 Gas and other businesses are able to share executive management and
3 administrative capabilities that are provided by CSS personnel.

4 **Q. HOW ARE CSS COSTS ASSIGNED TO THE VARIOUS BUSINESS**
5 **UNITS THAT ARE SERVED BY AND BENEFIT FROM THE**
6 **ACTIVITIES OF THE CSS PERSONNEL?**

7 A. We utilize a sophisticated activity-based cost allocation methodology to assign
8 CSS costs to the ultimate cost causer or consumer of a particular service. The
9 allocation of CSS costs is accomplished through a detailed cost model with
10 numerous cost drivers. The costs incurred by the CSS departments are initially
11 collected by function, or service performed, using direct assignments or percent of
12 time estimates by departmental subject matter experts. Once all the costs of a
13 function or service have been collected, the total cost of that function or service is
14 assigned to the various business units that consume that service. Costs of each
15 function or service are assigned to the consuming business unit based on a cost
16 driver that best explains how the particular service in question is consumed.

17 For example, the costs associated with providing payroll processing
18 (including labor, benefits, supplies, information system support, etc.) are assigned
19 to the various users of the payroll processing service based upon the number of
20 paychecks processed for the various divisions. In the same manner, costs
21 associated with the customer call center are assigned to Petitioner and Citizens
22 Gas of Westfield based on the number of customer calls.

Other examples of services and cost drivers include:

| <u>Service Performed</u> | <u>Cost Driver</u> |
|--------------------------|---------------------------------|
| PC Support | # of workstations |
| Benefit administration | # of active & retired employees |
| Pay vendors | # of invoice transactions |
| Bill customers | # of customer bills |
| Executive support | Time estimates |
| Facility costs | # of square feet used |
| Remittance processing | Direct assignment |
| Staffing services | # of projected new hires |

The objective of the cost allocation methodology is to assign the costs of CSS services as accurately as possible to the consumers or beneficiaries of each service.

Q. ARE CERTAIN CSS COSTS NOT CONDUCTIVE TO DIRECT ASSIGNMENT TO THE CONSUMERS OR BENEFICIARIES OF THE SERVICE BASED ON A COST DRIVER?

A. Yes. Certain CSS costs are overall entity costs incurred to support the consolidated charitable trust enterprise. Such costs are incurred because the Board has continuing beneficiary interests to satisfy and a purpose to fulfill in terms of its obligations to govern, manage, operate, regulate and control Citizens Gas, Citizens Thermal Energy (which includes the regulated steam utility), and other assets of the public charitable trust (the "Trust"). These CSS costs are classified as "Trust Administration" costs.

Q. ARE ALL ADMINISTRATIVE COSTS OF THE TRUST CHARGED TO TRUST ADMINISTRATION?

A. No. Let me provide an example of how administrative costs are distinguished between costs that are charged to a particular business unit and costs that are charged to Trust Administration. My time allocation provides a good illustration. When I am working directly with any particular business unit to provide financial expertise, planning and support to that unit, my time is charged directly to that unit. However, when I am engaged in strategic planning and administrative activities to assure that all activities of the Trust remain aligned toward the ultimate purpose of providing sustainable benefits to the Trust's beneficiaries, my time is charged to Trust Administration. The following table illustrates the allocation of my time during the test year:

| Business Unit | Time Allocation % |
|----------------------|-------------------|
| CBP | 15% |
| Gas Division | 41% |
| Manufacturing | 4% |
| Steam | 5% |
| Chilled Water | 5% |
| Trust Administration | 30% |

As the above example illustrates, Trust Administration costs are only a subset of total CSS charges.

Q. WHAT IS THE RATIO OF TRUST ADMINISTRATION COSTS TO THE TOTAL OF ALL CSS CHARGES?

1 A. During the test year, the total amount of CSS costs incurred on behalf of the entire
2 Trust was \$46,682,866 (see Petitioner's Exhibit JRB-7). Of that amount,
3 \$5,722,502 was for Trust Administration.

4 **Q. CAN YOU PROVIDE SOME EXAMPLES OF TRUST**
5 **ADMINISTRATION COSTS?**

6 A. Yes. In addition to executive administration of Trust matters and certain strategic
7 planning activities as illustrated above in the example of how my time was
8 allocated during the test year, other examples of Trust Administration costs
9 include fiduciary insurance, director and officer liability insurance, statutory fees
10 paid to members of the Board of Directors and Board of Trustees, preparation of
11 Trust-level financial reports, external audit fees, administration of the Trust-wide
12 quality program, internal controls administration and general Trust governmental
13 and other external relations not specifically related to a particular business unit.

14 **Q. HOW ARE TRUST ADMINISTRATION COSTS ALLOCATED TO THE**
15 **VARIOUS BUSINESS UNITS?**

16 A. Trust Administration costs are allocated to business units based on the respective
17 business unit's percentage of prior year revenues to total Trust prior year
18 revenues. The Commission determined this specific method of allocating Trust
19 Administration costs to be reasonable in its finding on page 44 of the October
20 2006 Order in Cause No. 42767.

1 Q. WHAT IS THE PURPOSE OF THE PRO FORMA ADJUSTMENTS YOU
2 HAVE MADE TO THE TEST YEAR AMOUNT AND ALLOCATION OF
3 CSS COSTS?

4 A. The purpose of the pro forma adjustments I make to test year CSS costs is to
5 provide Petitioner's witness Prentice with the appropriate Citizens Gas CSS cost
6 allocation percentages to be applied to the pro forma adjustments she makes to
7 total CSS labor, benefits and non-labor costs. It is important to understand with
8 respect to CSS labor and benefit costs that Mrs. Prentice calculates the going level
9 amount of such costs. My pro forma adjustments merely compute the going level
10 *percentage* of such costs that are allocable to Citizens Gas.

11 As Mr. Lykins explains in his testimony, the Board formerly operated a
12 coke manufacturing business (the "Manufacturing Division"), but discontinued
13 operation of its coke manufacturing plant in 2007. As a result, the percentage of
14 costs allocated to Citizens Gas (and all other non-Manufacturing business units)
15 during the test year is not reflective of the going level percentage because the
16 Manufacturing Division was incurring and consuming CSS costs during the more
17 than nine months it was active and operating during the test year. However,
18 cessation of manufacturing division operations is a significant change in the
19 makeup of the Trust's business units and means the test year percentage of total
20 CSS costs allocated to Citizens Gas (and all other non-Manufacturing business
21 units) understates the percentage of CSS costs that will be allocated to the Gas
22 Division (and all other non-Manufacturing business units) on a going-forward

1 basis. My pro forma adjustment is necessary because cessation of Manufacturing
2 Division operations is a fixed, known and measurable event. It has a fixed,
3 known and measurable impact on both the total amount of CSS costs and on the
4 allocation of those costs to Citizens Gas.

5 **Q. PLEASE EXPLAIN PETITIONER'S EXHIBIT JRB-7.**

6 A. Petitioner's Exhibit JRB-7 summarizes the pro forma reduction in the test year
7 amount of total CSS costs and the resulting allocation of such costs to all business
8 units of the Trust resulting from cessation of operations at the Manufacturing
9 Division.

10 As I explained above, the vast majority of CSS costs are allocated to
11 business units based on cost drivers that best explain how each particular CSS
12 service is consumed. In addition, the subset of total CSS costs known as Trust
13 Administration costs are allocated to business units based on the respective
14 business unit's percentage of prior year revenues to total Trust prior year
15 revenues. Petitioner's Exhibit JRB-7 first adjusts total Trust-wide CSS costs for
16 that portion of the anticipated reduction in such costs resulting from the
17 discontinuation of Manufacturing Division operations that was not fully realized
18 during the test year, and then reallocates the resulting CSS cost total to the various
19 business units based on the revised cost driver and percentage of revenue
20 allocation factors that ensued from discontinuation of Manufacturing Division
21 operations.

1 Line 15 of Petitioner's Exhibit JRB-7 shows the total pro forma reduction
2 in test year CSS costs resulting from discontinuation of Manufacturing Division
3 operations is \$1,705,390. Again, it should be understood that this amount
4 represents the portion of the reduction in such costs that was not fully realized
5 during the test year. A significant amount of CSS cost savings related to
6 cessation of Manufacturing Division operations was realized during the test year,
7 largely through personnel reductions and reductions in outside legal fees
8 occurring throughout the test year. Line 16 of Petitioner's Exhibit JRB-7 shows
9 the pro forma amount of test year CSS costs that remain after discontinuation of
10 Manufacturing Division operations is \$44,977,476.

11 Column B, lines 17 through 29 of Petitioner's Exhibit JRB-7 shows the
12 reallocation of the revised test year CSS costs to the respective business units as
13 well as to Trust Administration based on the revised cost drivers that remain upon
14 discontinuation of Manufacturing Division operations. Column D, lines 17
15 through 29 of Petitioner's Exhibit JRB-7, show the reallocation of the adjusted
16 test year Trust Administration costs to the respective business units based on the
17 test year proportion of revenue of each business to the total revenue of all
18 businesses that are part of the Trust, excluding the revenue of the Manufacturing
19 Division.

20 **Q. YOU TESTIFIED THAT THE \$1.7 MILLION OF CSS COST**
21 **REDUCTIONS APPEARING ON LINE 15 OF PETITIONER'S EXHIBIT**
22 **JRB-7 IS ONLY THE PORTION OF THE REDUCTION IN CSS COSTS**

1 **ENSUING FROM THE CESSATION OF MANUFACTURING**
2 **OPERATIONS THAT WAS NOT FULLY REALIZED DURING THE**
3 **TEST YEAR. WHAT IS THE TOTAL REDUCTION IN CSS COSTS**
4 **EMANATING FROM THE DISCONTINUATION OF MANUFACTURING**
5 **OPERATIONS?**

6 A. The total reduction in CSS costs that we anticipate achieving as a result of the
7 discontinuation of Manufacturing Division operations is \$2,919,101. Of that
8 amount, during fiscal year 2007 we achieved \$530,525 of reductions in labor and
9 benefits, \$42,157 of reductions in non-labor costs and \$641,028 of reductions in
10 outside legal costs.

11 **Q. WHAT IS THE REASON THE ENTIRE AMOUNT OF CSS COSTS**
12 **ALLOCATED TO THE MANUFACTURING DIVISION CANNOT BE**
13 **ELIMINATED FROM TOTAL CSS COSTS UPON DISCONTINUATION**
14 **OF MANUFACTURING OPERATIONS?**

15 A. CSS costs are not true variable costs. CSS costs do not rise and fall in direct
16 proportion to increases or decreases in the cost drivers that best allocate such
17 costs. For example, during the test year 4% of my time was dedicated to directly
18 supporting the Manufacturing Division and another 5% of my time was charged
19 to the Manufacturing Division through the allocation of Trust Administration

1 costs.⁶ This means a total of 9% of my time was allocated to the Manufacturing
2 Division during the test year. However, following cessation of Manufacturing
3 Division operations, the Trust continues to need a CFO, so a proportionally higher
4 percentage of my time is spent directly supporting other Divisions, including
5 Citizens Gas. In addition, the portion of my time that is spent on Trust
6 Administration matters will be allocated in greater proportion to the remaining
7 businesses, including Citizens Gas, based on the proportion of revenue of each
8 business to the total revenue of all businesses that are part of the Trust, excluding
9 the revenue of the discontinued Manufacturing Division.

10 Another example of a CSS cost that does not increase or decrease in direct
11 proportion to the change in the cost driver that allocates the cost is the cost of
12 preparing our Annual Report. Although 16.8% of the cost of preparing the
13 Annual Report was charged to the Manufacturing Division during the test year
14 through the allocation of Trust Administration costs, the total cost the Trust will
15 incur to prepare the Annual Report will not change materially as a result of
16 discontinuation of Manufacturing Division operations. This means each
17 remaining business will be charged a larger proportionate share of the cost of the
18 Annual Report based on the proportion of revenue of each business to the total
19 revenue of all businesses that are part of the Trust, excluding the revenue of the
20 Manufacturing Division.

⁶ 30% of my time is charged to Trust Administration and 16.8% of Trust Administration is charged to the Manufacturing Division, as the proportion of Manufacturing Division revenue to total Trust revenue is 16.8%. Consequently, $30\% \times 16.8\% = 5\%$.

1 The above examples of my time and the cost of the Annual Report are not
2 an exhaustive list of CSS costs that do not materially change because of the
3 cessation of the Manufacturing Division operations. They are merely
4 representative examples to help explain why the entire amount of CSS costs
5 allocated to the Manufacturing Division during the test year is not eliminated
6 upon cessation of Manufacturing Division operations. Determining the amount of
7 CSS costs that can be reduced upon cessation of Manufacturing Division
8 operations requires detailed analysis and managing the actual realization of such
9 identified cost savings requires a disciplined implementation plan.

10 **Q. HAS SUCH A DETAILED ANALYSIS AND IMPLEMENTATION PLAN**
11 **BEEN CONDUCTED?**

12 A. Yes. A team that includes all officers and department heads overseeing areas
13 engaged in CSS activities analyzed the impact on CSS activities of discontinuing
14 Manufacturing Division operations and identified the CSS activities that would be
15 reduced by cessation of Manufacturing Division operations. The team
16 accomplished this by identifying the CSS departments that were providing
17 services to the Manufacturing Division, or that charge time to Trust
18 Administration, and then performed a line-by-line review of all labor and other
19 costs incurred by such departments. The purpose of the line-by-line review was
20 to identify the costs that could be reduced or eliminated upon discontinuation of
21 Manufacturing Division operations.

1 One major activity of the team involved analyzing the amount of CSS full-
2 time equivalent employees that were allocated to the Manufacturing Division.
3 Petitioner's Exhibit JRB-8, Column A, shows a full-time equivalent of 16.84 CSS
4 employees were directly allocating time to the Manufacturing Division at the
5 beginning of fiscal year 2007.⁷ Petitioner's Exhibit JRB-8, Column C, shows an
6 additional 5.23 full-time equivalent CSS employees indirectly allocated time to
7 the Manufacturing Division through the allocation of Trust Administration costs.
8 This amounts to a total full-time equivalent of 22.07 CSS employees allocating
9 time to the Manufacturing Division at the beginning of fiscal year 2007, as shown
10 on Petitioner's Exhibit JRB-8, Column D. The team determined of that amount,
11 19 CSS positions could be reduced upon cessation of Manufacturing Division
12 operations. I want to emphasize that the team based its study of CSS reductions
13 on *full time equivalent* (FTE) positions, not merely on positions that were 100%
14 dedicated to supporting the Manufacturing Division. Indeed, 16 of the 19
15 positions that were eliminated as a result of closing the Manufacturing Division
16 were eliminated as a result of reengineering, restructuring and consolidation of
17 tasks. A detailed description of the study results documenting the CSS positions
18 to be eliminated upon cessation of Manufacturing Division operations and
19 documenting why certain CSS departments could not reduce full-time equivalent
20 positions by the amount such positions were allocated to the Manufacturing
21 Division is included in the workpapers filed in this case.

⁷ This is the relevant and appropriate measurement period because it was prior to commencement of

1 **Q. WAS THE PLAN OF REDUCING THE CSS WORKFORCE BY 19**
2 **EMPLOYEES DUE TO THE CESSATION OF MANUFACTURING**
3 **DIVISION OPERATIONS REALIZED?**

4 **A.** Yes. We accomplished the targeted CSS workforce reduction it targeted through
5 a combination of attrition (certain positions became open through normal
6 retirements and turnover and were not filled), termination and an early retirement
7 offering for CSS employees exclusively. The CSS workforce reduction plan was
8 not complete by the end of the test year, but the targeted reduction of 19 positions
9 has now been achieved. Mrs. Prentice made certain in her employee-by-
10 employee computation of going level CSS labor costs that all such CSS positions
11 were eliminated.

12 **Q. DID THE TEAM CONDUCT A SIMILAR LINE-BY-LINE REVIEW OF**
13 **CSS NON-LABOR COSTS TO ASSESS THE IMPACT OF THE**
14 **MANUFACTURING DIVISION CLOSURE ON SUCH COSTS?**

15 **A.** Yes. Petitioner's Exhibit JRB-9 shows each CSS department's non-labor costs
16 that were directly allocated to the Manufacturing Division during the test year, as
17 well as each line item of such costs that were indirectly allocated to the
18 Manufacturing Division through the allocation of Trust Administration costs.
19 Petitioner's Exhibit JRB-9, Column D, shows the total amount of CSS non-labor
20 costs allocated to the Manufacturing Division during the test year was \$1,682,243.
21 The team determined that \$1,375,997 of non-labor CSS costs could be reduced

winding down Manufacturing Division operations in anticipation of plant closure.

Direct Testimony and Exhibits of John R. Brehm
Petitioner's Exhibit JRB
Citizens Gas & Coke Utility
Page No. 35 of 35

1 upon cessation of Manufacturing Division operations. Of that amount, \$683,185
2 was eliminated during the test year, primarily in the category of outside legal
3 costs, and \$692,812 was not eliminated during the test year. The latter amount is
4 the amount shown in Column E of Petitioner's Exhibit JRB-9. A summary
5 documenting the CSS non-labor costs to be eliminated upon cessation of
6 Manufacturing operations and documenting why certain CSS departments could
7 not reduce CSS non-labor costs by the amount such costs were allocated to the
8 Manufacturing Division during the test year is included in the filed workpapers in
9 this case.

10 **Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-10.**

11 A. Petitioner's Exhibit JRB-10 summarizes the impact to Citizens Gas of the pro
12 forma adjustment to the test year allocation of CSS costs that result from the
13 discontinuation of Manufacturing Division operations. The percentages on line 3
14 of Petitioner's Exhibit JRB-10 serve as inputs to the pro forma adjustments Mrs.
15 Prentice makes with respect to CSS costs.

16 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

17 A. Yes, at this time.

1
2 **VERIFICATION**
3

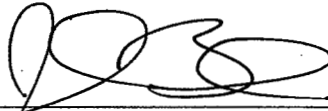
4 STATE OF INDIANA)

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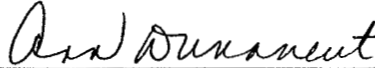
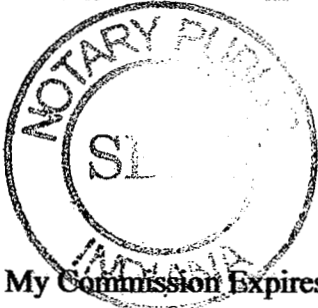
The undersigned, John R. Brehm, under penalties of perjury and being first duly sworn on his oath, says that he is Senior Vice President and Chief Financial Officer of Citizens Gas & Coke Utility; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.



By: John R. Brehm

Senior Vice President and Chief Financial Officer
Citizens Gas & Coke Utility

Subscribed and sworn to before me, a Notary Public, this 17th day of March, 2008.



Signature



Printed Name

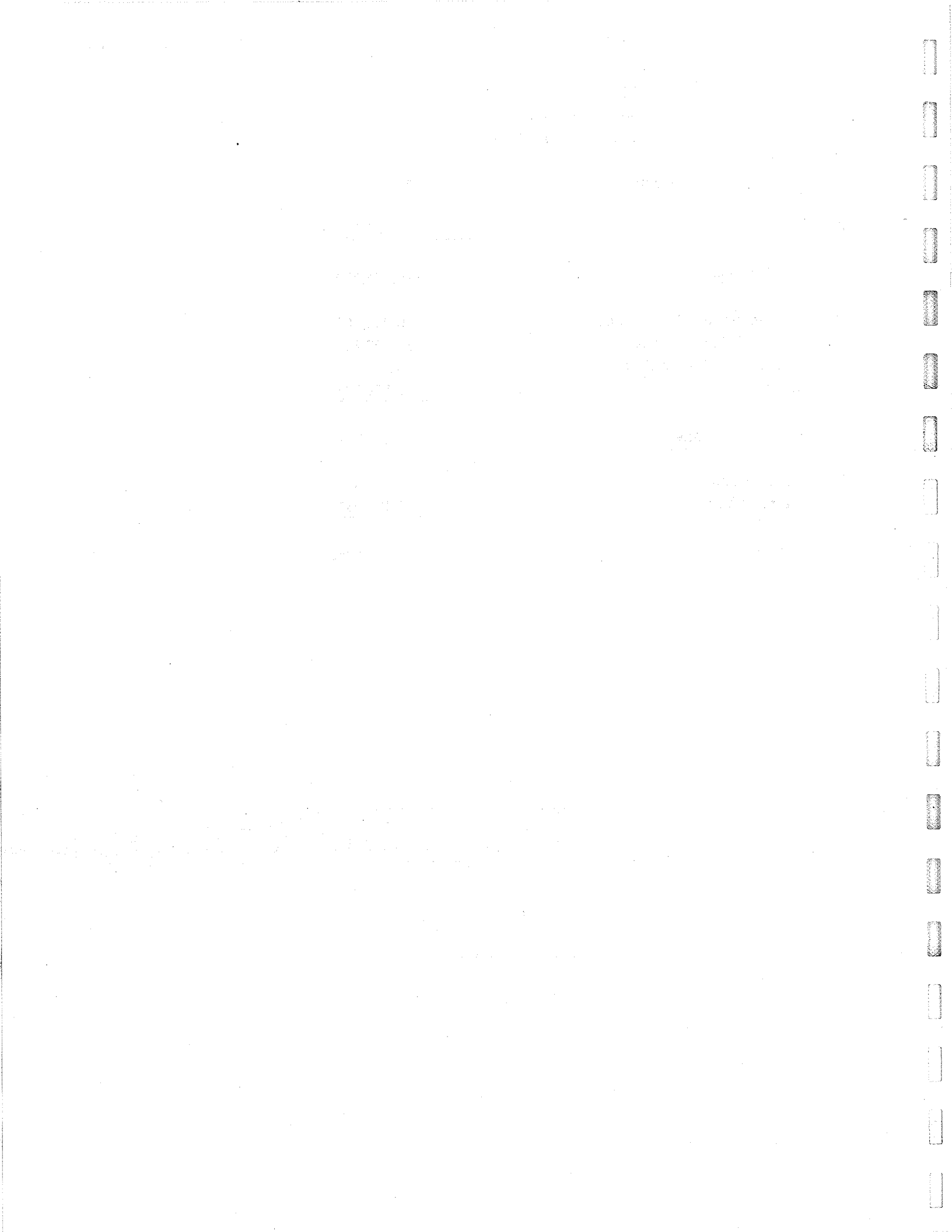
My Commission Expires: 08/11/08

My County of Residence: Lancaster



Citizens Gas
Statement of Operations
12 Months Ended September 30, 2007

| <u>Line No.</u> | | |
|-----------------|-----------------------------|--------------------|
| 1 | Total Operating Revenues | 419,270,950 |
| 2 | Gas Cost | <u>299,826,241</u> |
| 3 | Gross Margin | 119,444,709 |
| 4 | Operations and Maintenance | 40,938,560 |
| 5 | General & Administrative | 35,092,225 |
| 6 | Depreciation & Amortization | 18,014,086 |
| 7 | Taxes | <u>11,158,097</u> |
| 8 | Operating Income | 14,241,741 |
| 9 | Other Income | 2,719,886 |
| 10 | Interest Charges | <u>20,402,031</u> |
| 11 | Net Income | (3,440,404) |



Citizens Gas
Statement of Financial Position
At September 30, 2007

Line No.Assets

Utility Plant:

| | | |
|---|-------------------------------|---------------|
| 1 | Utility Plant in Service | 614,627,047 |
| 2 | Accumulated Depreciation | (346,962,464) |
| 3 | Net Plant in Service | 267,664,583 |
| 4 | Construction Work in Progress | 14,800,867 |
| 5 | Net Utility Plant | 282,465,450 |

Investments:

| | | |
|---|-------------------------------------|-----------|
| 6 | Bond Principal Retirement Funds | 1,358,670 |
| 7 | Bond Interest Payment Funds | 1,289,950 |
| 8 | Price Volatility Mitigation Program | 2,860,312 |
| 9 | Total Investments | 5,508,932 |

Current Assets:

| | | |
|----|---------------------------------|-------------|
| 10 | Cash and Short-Term Investments | 76,518,533 |
| 11 | Accounts Receivable | 19,495,624 |
| 12 | Accrued Utility Revenue | 5,328,123 |
| 13 | Natural Gas in Storage | 94,713,747 |
| 14 | Materials and Supplies | 1,670,968 |
| 15 | Prepayments and Deposits | 798,314 |
| 16 | Other Current Assets | 1,235,837 |
| 17 | Total Current Assets | 199,761,146 |

Deferred Charges and Other Non-Current Assets:

| | | |
|----|---|------------|
| 18 | Bond Issuance Costs, net | 21,940,580 |
| 19 | Prepaid Retirement Benefit Costs | 423,027 |
| 20 | Other Deferred Charges | 5,189,691 |
| 21 | Total Deferred Charges and Other Non-Current Assets | 27,553,298 |

| | | |
|----|--------------|-------------|
| 22 | Total Assets | 515,288,826 |
|----|--------------|-------------|

Capitalization and Liabilities

Capitalization:

| | | |
|----|--|--------------|
| 23 | Retained Earnings | 64,660,194 |
| 24 | Accumulated Other Comprehensive Income (Loss) | (31,335,671) |
| 25 | Long-Term Debt | 328,450,000 |
| 26 | Unamortized Premium and (Discount) on Long-Term Debt | (9,507,757) |
| 27 | Other Long-Term Liabilities | 12,173,278 |
| 28 | Total Capitalization | 364,440,044 |

Current Liabilities:

| | | |
|----|--------------------------------------|-------------|
| 29 | Current Maturities of Long-Term Debt | 9,175,000 |
| 30 | Tax-Exempt Commercial Paper | 50,000,000 |
| 31 | Accounts Payable | 36,293,772 |
| 32 | Accrued Expenses | 19,753,498 |
| 33 | Accrued Taxes | 7,340,800 |
| 34 | Customer Deposits | 12,525,962 |
| 35 | Customer Benefit Distribution | 2,860,307 |
| 36 | Refundable Gas Costs | 12,448,239 |
| 37 | Other Current Liabilities | 451,204 |
| 38 | Total Current Liabilities | 150,848,782 |

| | | |
|----|--------------------------------------|-------------|
| 39 | Total Capitalization and Liabilities | 515,288,826 |
|----|--------------------------------------|-------------|

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Citizens Gas
Schedule of Test Year and Pro Forma Debt Service
(In Dollars)

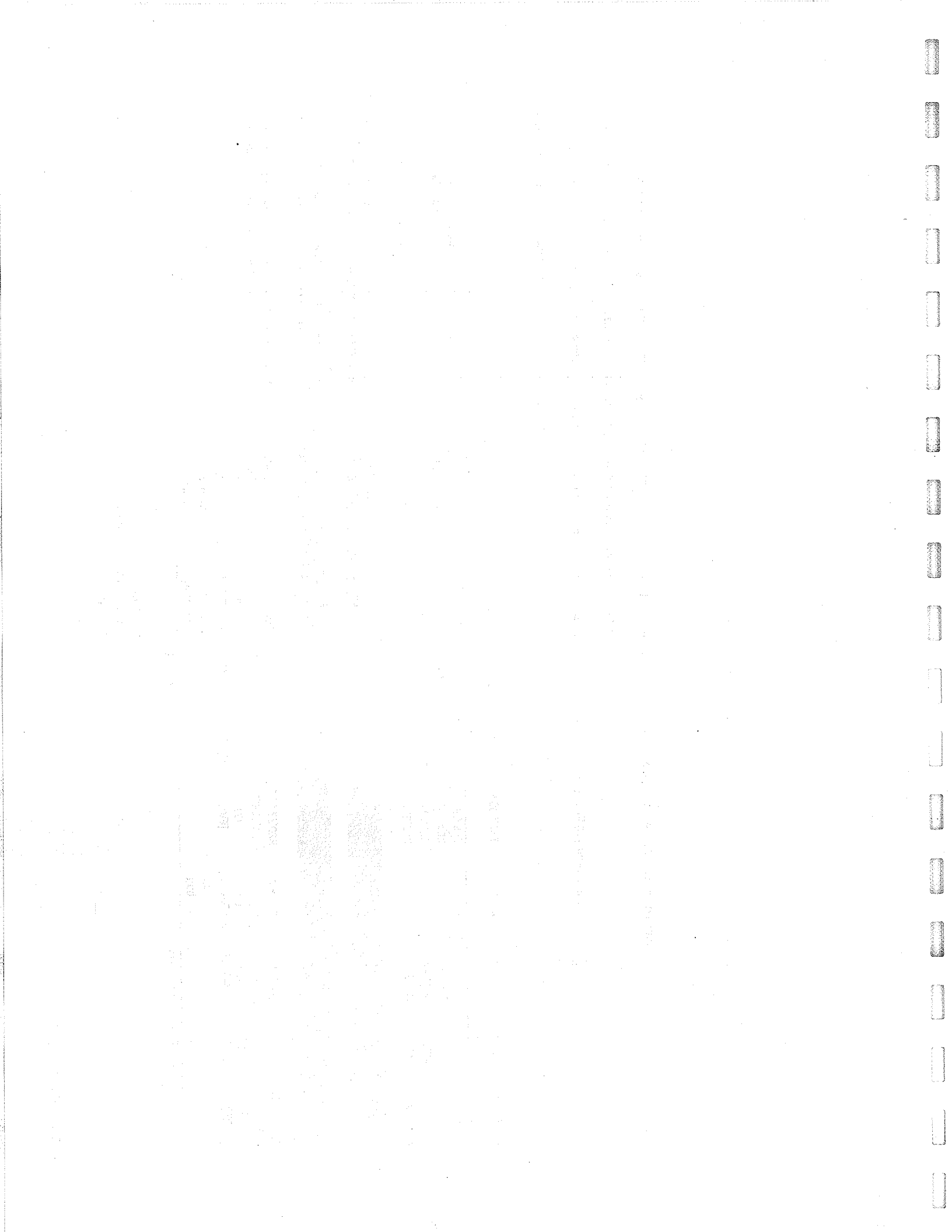
| Line No. | | Test Year Debt Service | | | | | Pro Forma Debt Service | | | | |
|-------------|--|--|-------|------------------------------------|------------|------------|------------------------|------------------------------------|------------|------------|------------|
| | | Principal Outstanding at 9/30/2007 | Notes | Required Principal Repayment | Interest | Other Cost | Total | Required Principal Repayment | Interest | Other Cost | Total |
| | | (A) | | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) |
| 1 | Gas Utility System Bonds, Series 1986 B | 60,560,000 | | - | 2,313,625 | - | 2,313,625 | - | 2,313,625 | - | 2,313,625 |
| 2 | Gas Utility Distribution System Bonds, Series 1998 A | 106,075,000 | | 6,920,000 | 5,807,038 | - | 12,727,038 | 7,315,000 | 5,389,158 | - | 12,704,158 |
| 3 | Gas Utility Distribution System Bonds, Series 2001 | 102,375,000 | | | 3,702,262 | 279,360 | 3,981,622 | | | | |
| 4 | Gas Utility Distribution System Bonds, Series 2008 A | | (1) | | | | | | 6,519,062 | | 6,519,062 |
| 5 | Gas Utility Distribution System Bonds, Series 2003 A | 68,615,000 | | 1,765,000 | 3,121,918 | 137,236 | 5,024,154 | | | | |
| 6 | Gas Utility Distribution System Bonds, Series 2008 B | | (2) | | | | | 1,860,000 | 3,180,870 | 505,890 | 5,546,760 |
| 7 | Tax-Exempt Commercial Paper | 50,000,000 | | - | 1,850,247 | 88,991 | 1,939,238 | - | 1,525,821 | 88,991 | 1,614,812 |
| 8 | Bank Line of Credit | - | (3) | - | 178,806 | 35,585 | 214,391 | - | 265,130 | 35,585 | 300,715 |
| 9 | Customer Deposits | 12,526,365 | (4) | - | 597,482 | - | 597,482 | - | 438,423 | - | 438,423 |
| 10 | Other Debt Portfolio Administration Expenses | N/A | | - | - | 60,841 | 60,841 | - | - | 60,841 | 60,841 |
| 11 | Total Debt Service | | | 8,685,000 | 17,571,378 | 652,013 | 26,908,391 | 9,175,000 | 19,632,089 | 691,307 | 29,498,396 |

Note 1: Assumes a refunding bond issue of \$113,375,000 at 5.75%.

Note 2: Assumes a refunding bond issue of \$69,300,000 at 4.59%. Other cost assumes Letter of Credit @ 65 basis points plus remarketing @ 8 basis points.

Note 3: Pro forma interest is the 3-year average of actual FY 2005, 2006 and 2007 bank line of credit interest expense.

Note 4: Pro forma interest is IURC published customer deposit rate of 3.5% multiplied by the 13 month actual test year average of customer deposits outstanding.



March 6, 2008

**Gas Utility Distribution System and
Thermal Energy System
Background Paper**

Subject:

Refinancing of Variable Rate Auction Rate Notes

Board Review Date: March 11, 2008

Desired Outcome:

Approval for Citizens to refinance approximately \$220 million worth of Variable Auction Rate Notes including the 2001 Gas Utility Distribution Bonds, the 2003A Gas Utility Distribution Bonds and the 2001B Thermal Energy System Bonds.

Background:

The Gas Utility Distribution System (GUDS) issued \$102,375,000 of Series 2001 auction rate notes in May 2001 and \$76,070,000 of Series 2003A auction rate notes in June 2003 to refund prior debt obligations. In addition, the Thermal Energy System (Thermal System) issued \$48,775,000 of Series 2001B auction rate notes in January 2001 to finance a portion of the acquisition of the Thermal System. Citizens utilized variable-rate auction rate notes to (i) ensure that its debt portfolio would include an amount of long-term insured, tax-exempt debt, and (ii) take advantage of the short end of the yield curve by resetting interest rates every seven days at a rate determined through an auction conducted by a third-party broker-dealer and auction agent. Use of this auction rate debt instrument provided diversification of interest rate risk and reduced Citizens' borrowing costs significantly, with weekly auction rates that ranged from less than 1% to 3.95%, through January 2008.

Unfortunately, credit concerns regarding the bond insurers, including the insurers of Citizens' auction rate debt, began to emerge in late 2007 due to the theretofore unknown credit exposure that insurers had to the sub-prime mortgage crisis that has been well-publicized in both the financial and popular press. As a result, several of the primary bond insurers were downgraded from AAA ratings in early 2008. Citizens' GUDS auction rate notes were insured by Ambac Assurance Corporation, whose long-term credit rating was downgraded from AAA to AA by Fitch on January 18, 2008.

As a result of actual and rumored insurer downgrades, investor participation in the auction rate market dropped precipitously and auctions across the country began to fail in their weekly remarketing of bonds offered for sale. When bonds that are offered for sale do not receive sufficient clearing bids, the holders of those securities are required to continue holding those bonds at interest rates determined through a formula prescribed in the offering documents. These rates are generally higher than comparable tax-exempt money market rates in order to compensate the investors for holding securities they no longer desire to hold. As a protective measure for issuers, the offering documents also include maximum rates at which the bonds can pay interest.

March 6, 2008

Citizens has experienced failed auctions on its Gas Utility Distribution System Series 2001 and Series 2003A auction rate notes beginning with the February 15, 2008 auction, and on the Thermal Energy System Series 2001B auction rate notes beginning with the February 13, 2008 auction. Prior to this time, the auction rate notes were experiencing weekly reset rates between 3.50% and 3.90%. Since that time, the weekly rates have reset between 5.40% and 8.75%.

Citizens believes the auction rate market may be permanently impaired. Accordingly, it has developed a plan to refund the GUDS Series 2001 and Series 2003A auction rate notes and the Thermal System Series 2001B auction rate notes.

Refunding Plan:

Auction rate notes are in widespread use across the spectrum of municipal debt issuers. For example, a partial list of notable auction rate issuers in Indiana includes Duke Energy, Vectren, the State of Indiana and Indianapolis Waterworks. Consequently, the current market for municipal debt is very fluid, as virtually all issuers across the U.S. are seeking to refinance outstanding auction rate debt, which could mean as much as \$40 billion of new municipal debt may be offered for sale in the market within the next month. As a result, Citizens has developed a refunding plan that preserves multiple refunding options which can be selected and executed based on market conditions existing at the time of pricing each refunding issue.

Given the market unpredictability of the liquidity risk and interest cost of municipal variable rate debt alternatives, it is our recommendation to the Board to reduce the percentage of our total debt portfolio that utilizes floating rate debt. Consequently, Citizens' current working plan is to refund the GUDS Series 2001 and the Thermal Series 2001B bonds with long-term uninsured, fixed-rate bonds with maturities that match the original maturity dates of the refunded bonds. Such refunding bonds will be designated as GUDS Series 2008A Bonds and Thermal Series 2008 Bonds. Although we currently plan to issue the refunding bonds as fixed rate bonds, we have not determined whether to fix the rate for the life of the bonds, or fix the rate to a "put date" (*i.e.*, 3 or 5 years from the date of issuance) with a new fixed rate to be established at the time of the put date. The potential advantage of issuing so-called "put bonds" is that the current yield curve is quite steep (*i.e.*, shorter maturity interest rates are materially lower than longer maturity interest rates).

Given that such a large volume of new municipal bonds is likely coming to the market over the next 30 days, there is some risk that municipal interest rates may be inflated due to the laws of supply and demand. That may imply a wise course of action could be to issue put bonds to fix the rates for an intermediate period of time and then establish a new fixed rate on the put date at a time when the market is possibly less challenging. Of course, the risk in that strategy is that interest rates at the put date could be higher. If we were to go forward with put bonds, we would seek to be certain that the liquidity risk in the event of a failed remarketing at the time of the put is on the bondholders (that is the current market convention, but the market is subject to change). If we could not achieve that provision, we would most likely not issue put bonds and would fix the rate for the

March 6, 2008

life of the bonds. Of course, the default interest rate we would be required to pay in the event of such a failed remarketing would be high.

The proposed Board resolutions delegate the authority for making a final determination among the alternative courses of action described above to management based upon the advice of counsel and underwriters after considering market conditions at the time of actually marketing the bonds. The resolution for the GUDS Series 2008A Bonds also provides the option of refunding interim debt up to \$10 million. This option provides the flexibility to partially rebuild the GUDS treasury that has been used to fund GUDS operating deficits that began occurring in 2004, and continues through the present time.

Refunding the GUDS Series 2003A bonds presents an additional set of criteria to analyze because contemporaneously with issuing those auction rate bonds Citizens entered into an interest rate swap with the goal of synthetically creating a fixed rate transaction at a rate of 4.59% plus the annual cost of remarketing of .26% for an all-in fixed rate of 4.85%. Citizens is currently experiencing an 8.06% all-in cost on the Series 2003A bonds because of the current swap mismatch between the floating rate we are paying on the underlying auction rate notes (5.40%) and the 70% of LIBOR floating rate we are receiving under the terms of the swap (70% of current LIBOR rate of 3.13% equals 2.19%). This results in an all-in cost of 8.06% which is computed by adding 5.40% less 2.19% plus the 4.59% fixed rate on the swap plus the .26% cost of remarketing for a total of 8.06%.

Citizens' tentative plan with respect to refunding the GUDS Series 2003A bonds is to replace such auction rate notes with Variable Rate Demand Bonds (VRDBs). VRDBs are a form of long-term floating rate debt. However, unlike auction rate notes which place the liquidity risk of a failed remarketing on the bondholders; VRDBs place such liquidity risk on the issuer. That means VRDBs must be backed up with an irrevocable letter of credit from a bank with a high credit rating to assure the market that the issuer has access to adequate liquidity. Unlike auction rate notes, the remarketing of VRDBs in the current market environment has not been subject to widespread failures, which indicates continued market acceptance of floating rate instruments if liquidity risk is placed on the issuer. However, the interest rate established each week on VRDBs has been volatile lately – three weeks ago the rates on VRDBs were set at approximately 40% of LIBOR, two weeks ago such rates were set at approximately 75% of LIBOR and last week such rates were set at 101% of LIBOR. As a reference, historically VRDB rates have approached 70% of LIBOR.

Although issuing VRDBs is our preferred course of action, the plan to do so is tentative because there are many hurdles to overcome. The cost of securing a bank letter of credit has risen dramatically in the current market. We are currently negotiating terms with **Confidential Information - Redacted**, but there is no guarantee such negotiation will conclude successfully. In addition, there is risk that the interest rates on VRDBs will not return to the historical average of 70% of LIBOR. That would create a continuing mismatch on our swap because it is a 70% of LIBOR swap.

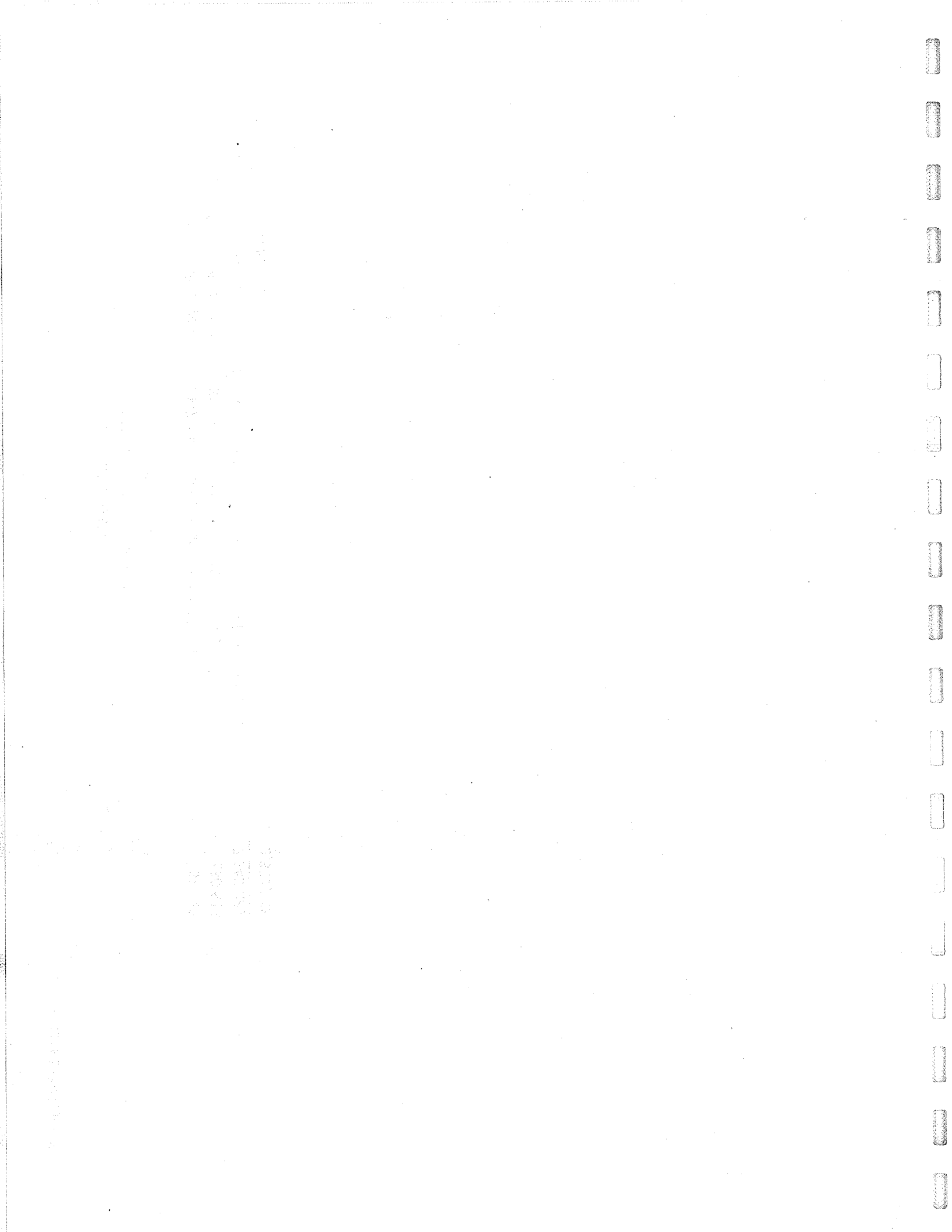
March 6, 2008

Assuming the floating rate we pay on the VRDBs averages 70% of LIBOR over time, the two floating legs of the transaction offset one another and result in our effective interest rate being fixed at 4.59%, plus the annual cost of the letter of credit, plus the cost of remarketing. However, to the extent the interest rate on VRDBs departs from the historical average of 70% of LIBOR, we are at risk of a mismatch on the two floating legs of the swap. Because of the aforementioned hurdles and risks, our backup plan is to unwind the swap and issue fixed rate bonds, which would require us to go through the same "put" vs. fixed rate for life of the bonds analysis described above. Unwinding the interest rate swap presently would result in our paying an effective fixed rate on the refunding of 6.43%. However, that is still lower cost than the 8.06% all-in cost we are currently experiencing.

The proposed Board resolutions with respect to refunding the GUDS Series 2003A bonds delegate the authority for making a final determination among the alternative courses of action described above to management based upon the advice of counsel and underwriters, after considering market conditions at the time of actually marketing the bonds.

Citizens Gas
Pro Forma Interest Income
(In Dollars)

| | |
|---|------------------|
| 3 year average of actual fiscal year 2005-2007 bond principal fund interest income | 67,442 |
| 3 year average of actual fiscal year 2005-2007 bond interest fund interest income | 150,516 |
| 3 year average of actual fiscal year 2005-2007 temporary cash investments interest income | <u>2,143,287</u> |
| Pro Forma Interest Income | 2,361,245 |

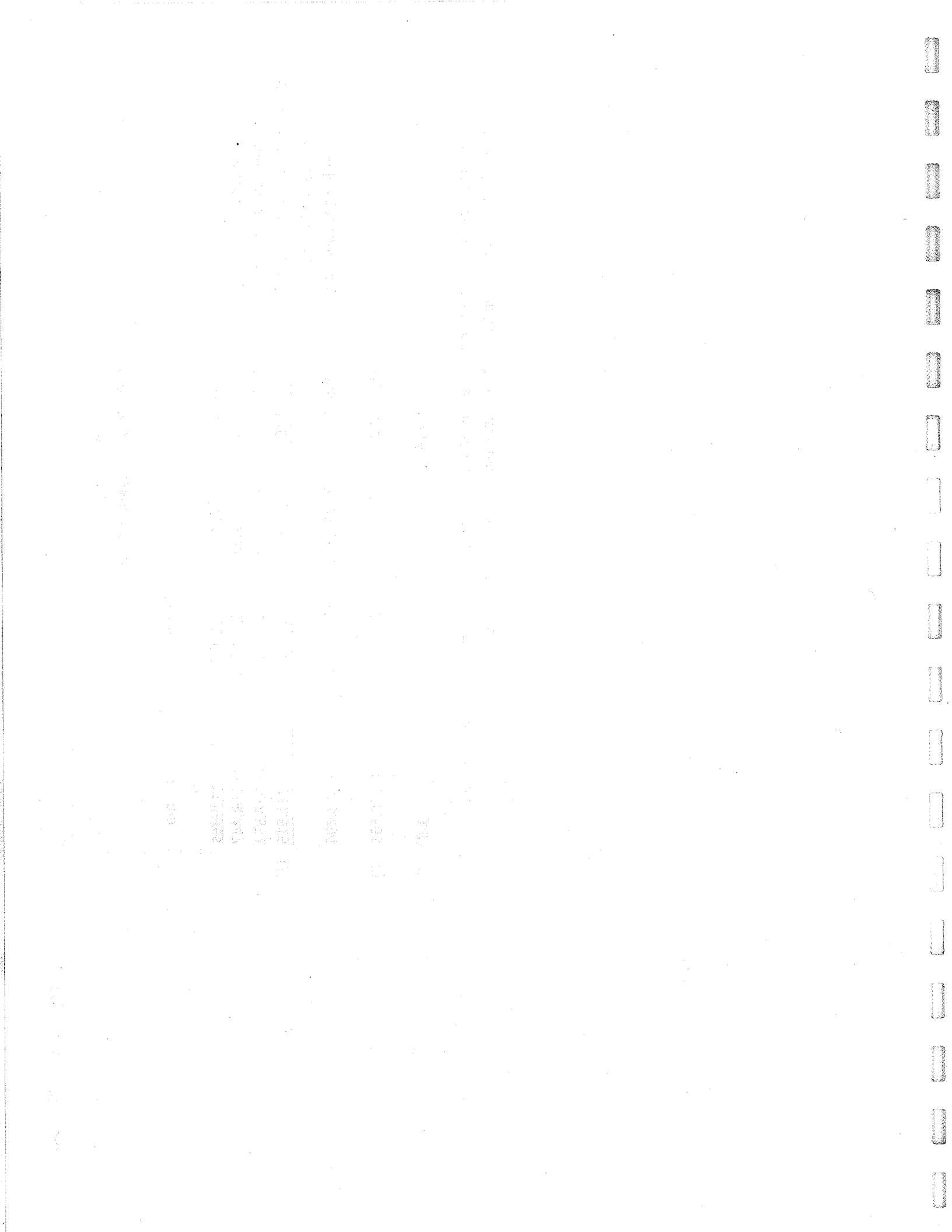


**Citizens Gas
Debt Service Coverage Ratio**

| | <u>2006</u> | <u>2007</u> | Pro Forma at <u>Present Rates</u> | Pro Forma at <u>Proposed Rates</u> |
|--|----------------|------------------|---|--|
| Operating Income | 85,440 | 14,241,738 | 12,341,715 | 31,603,447 |
| Depreciation and Amortization | 18,336,558 | 19,165,951 | 19,528,332 | 19,528,332 |
| Other Income and Deductions | <u>150,159</u> | <u>2,719,886</u> | <u>1,231,515</u> (1) | <u>1,231,515</u> (1) |
| Earnings Before Interest, Depreciation and Amortization | 18,572,157 | 36,127,575 | 33,101,562 | 52,363,294 |
| Debt Service | 25,175,104 | 25,658,896 | 28,368,666 (2) | 28,368,666 (2) |
| Debt Service Coverage Ratio | 0.74 | 1.41 | 1.17 | 1.85 |

(1) Includes interest income, debt portfolio administration expenses and interest on customer deposits

(2) Excludes debt portfolio administration expenses and interest on customer deposits



Proforma Adjustment to CSS Allocations for Closure of Manufacturing DivisionActual test year CSS Cost Allocations **reflecting** 3 months of Manufacturing Division closure:

| A | B | C | D | E |
|---|---------------------|---|-------------------|--|
| <u>Business Unit</u> | <u>Total CSS \$</u> | <u>Trust Administration</u> <u>Alloc % (a)</u> | <u>Alloc \$\$</u> | <u>Total CSS</u> <u>Allocations</u> |
| 1 Gas Division | 29,714,783 | 68.0% | 3,889,587 | 33,604,370 |
| 2 Manufacturing Div | 2,824,596 | 16.8% | 961,379 | 3,785,975 |
| 3 Oil Division | 76,212 | 0.8% | 42,919 | 119,131 |
| 4 Steam Division | 2,497,686 | 8.3% | 472,679 | 2,970,365 |
| 5 WSCW Division | 692,946 | 3.8% | 214,589 | 907,535 |
| 6 ICE Division | 212,454 | 1.1% | 61,231 | 273,685 |
| 7 Lilly Corp Center | 200,590 | 0.1% | 6,295 | 206,885 |
| 8 Lilly Greenfield | 163,635 | 0.1% | 6,295 | 169,930 |
| 9 Credit Union | 21,634 | | | 21,634 |
| 10 Westfield Gas | 233,230 | | | 233,230 |
| 11 CBP/Affiliates | 1,865,107 | 1.2% | 67,528 | 1,932,635 |
| 12 Trust Holdings | 2,457,491 | | | 2,457,491 |
| 13 Trust Administration | 5,722,502 | -100.0% | (5,722,502) | - |
| 14 Total CSS Costs | 46,682,866 | 0.00% | - | 46,682,866 |
| 15 Proforma Reduction in CSS costs for full year closure of Manufacturing | (1,705,390) | | | |
| 16 Revised CSS Costs | 44,977,476 | | | |

CSS Cost Allocations **excluding** Manufacturing Division for full year:

| | | | | |
|-------------------------|------------|---------|-------------|------------|
| 17 Gas Division | 30,978,389 | 81.70% | 4,451,576 | 35,429,965 |
| 18 Manufacturing Div | - | 0.00% | - | - |
| 19 Oil Division | 80,069 | 0.90% | 49,040 | 129,109 |
| 20 Steam Division | 2,393,109 | 9.92% | 540,510 | 2,933,619 |
| 21 WSCW Division | 825,460 | 4.51% | 245,734 | 1,071,194 |
| 22 Ice Division | 227,647 | 1.29% | 70,292 | 297,939 |
| 23 Lilly Corp Center | 226,592 | 0.13% | 7,082 | 233,674 |
| 24 Lilly Greenfield | 181,623 | 0.13% | 7,082 | 188,705 |
| 25 Credit Union | 28,743 | | - | 28,743 |
| 26 Westfield Gas | 208,472 | | - | 208,472 |
| 27 CBP/Affiliates | 1,921,197 | 1.42% | 77,369 | 1,998,566 |
| 28 Trust Holdings | 2,457,491 | | - | 2,457,491 |
| 29 Trust Administration | 5,448,685 | -100.0% | (5,448,685) | |
| 30 Total CSS Costs | 44,977,477 | 0.00% | - | 44,977,477 |

note (a) - Trust administration costs are allocated based upon % of total revenue

1. The first part of the document is a list of names and addresses. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

2. The second part of the document is a list of names and addresses, similar to the first part. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

3. The third part of the document is a list of names and addresses, similar to the first two parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

4. The fourth part of the document is a list of names and addresses, similar to the first three parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

5. The fifth part of the document is a list of names and addresses, similar to the first four parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

6. The sixth part of the document is a list of names and addresses, similar to the first five parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

7. The seventh part of the document is a list of names and addresses, similar to the first six parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

8. The eighth part of the document is a list of names and addresses, similar to the first seven parts. The names are written in a cursive script, and the addresses are written in a more formal, printed style. The list is organized into columns, with names in the first column and addresses in the second column.

Impact of Closure of Manufacturing Division on CSS Full-Time Equivalent Employees FY2007
Reflects Full Year of Mfg in Operation

| | A | B | C | D | E |
|---------------------|--|--|--|--|---|
| Department | CSS FTE Allocated to Mfg Div FY2007 | CSS FTE Allocated to Trust Admin FY2007 | 22.4% Trust Admin FTE to Mfg Div [A x B] | Total CSS FTE Allocated to Mfg Div [A + C] | To-date Reductions in CSS FTE re Mfg Closure |
| 1 Executive | 0.30 | 2.14 | 0.48 | 0.78 | - |
| 2 Safety | 0.79 | 2.00 | 0.45 | 1.24 | (2.00) |
| 3 Procurement | - | 2.50 | 0.56 | 0.56 | (1.00) |
| 4 Finance | 2.88 | 4.81 | 1.08 | 3.96 | (4.00) |
| 5 Treasury | 0.62 | 0.68 | 0.15 | 0.77 | (1.00) |
| 6 Risk Mgmt | 1.15 | 2.48 | 0.56 | 1.71 | (1.00) |
| 7 Int Audit | - | 5.00 | 1.12 | 1.12 | (1.00) |
| 8 Human Resources | 4.88 | 2.06 | 0.46 | 5.34 | (4.00) |
| 9 Info Services | 4.46 | - | - | 4.46 | (4.00) |
| 10 Corp Affairs | 0.49 | 1.00 | 0.22 | 0.71 | - |
| 11 Env Affairs | 0.53 | - | - | 0.53 | - |
| 12 Legal | 0.38 | - | - | 0.38 | - |
| 13 G.O. Security | 0.35 | 0.65 | 0.15 | 0.50 | - |
| 14 Cust Svcs | - | - | - | - | - |
| 15 Rates | - | - | - | - | - |
| 16 Marketing | - | - | - | - | (1.00) |
| 17 Strategic Growth | - | - | - | - | - |
| 18 Total | <u>16.84</u> | <u>23.32</u> | <u>5.23</u> | <u>22.07</u> | <u>(19.00)</u> |

note: column A represents FTE's allocated specifically to Mfg division via cost drivers
like # employees, % of time estimates, # of PC's, etc.

SECRET

100-100000

100-100000



Impact of Closure of Manufacturing Division on CSS NonLabor FY2007

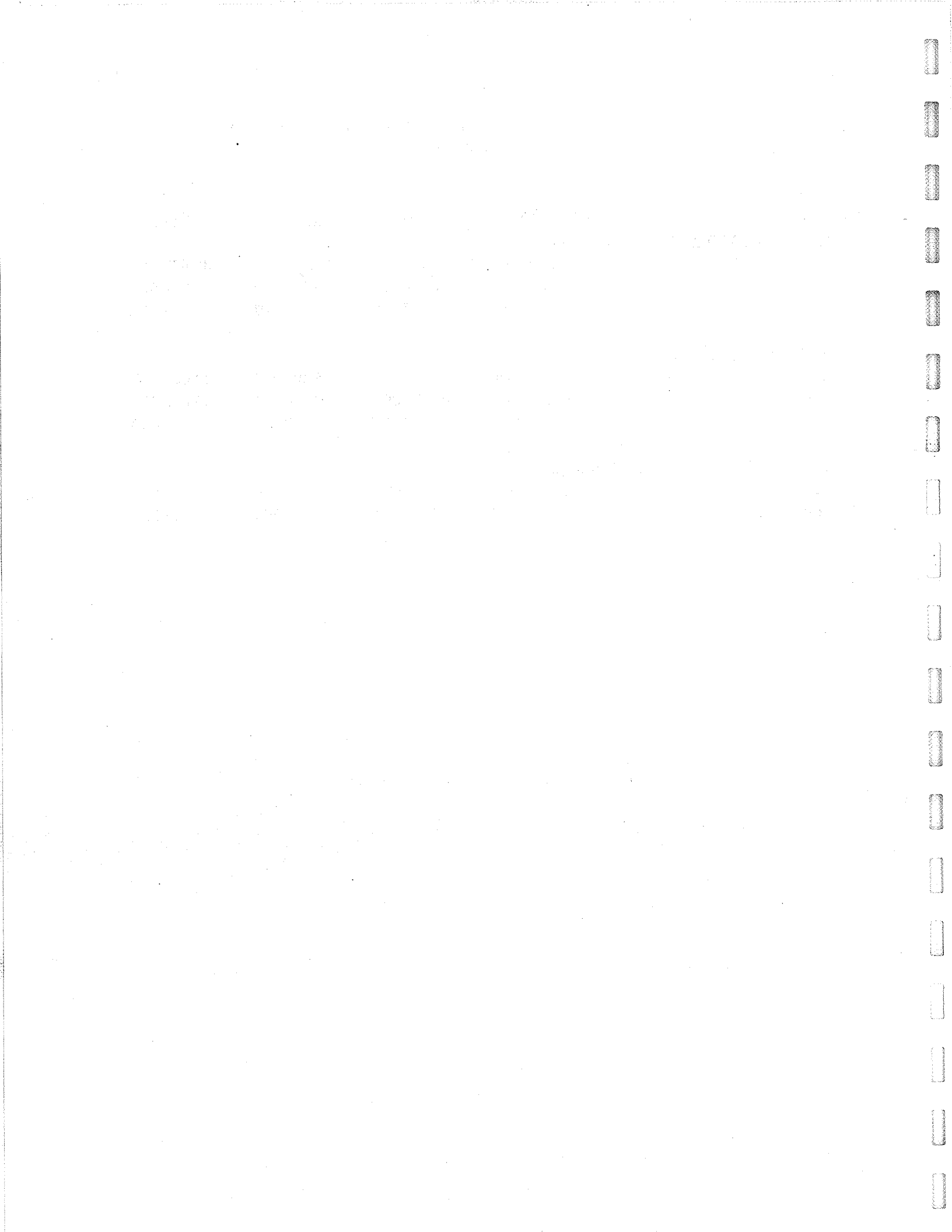
| Department | A | B | C | D | E |
|---------------------------|--|--|--|---|---|
| | CSS NonLabor Allocated to Mfg Div | CSS NonLabor Allocated to Trust Admin | 16.8% Trust Admin FTE to Mfg Div [A x B] | Total CSS NonLabor Allocated to Mfg Div [A + C] | Planned Reductions in CSS NonLabor re Mfg Closure |
| 1 Executive | - | 316,905 | 53,240 | 53,240 | - |
| 2 Safety | - | 82,959 | 13,937 | 13,937 | (18,928) |
| 3 Procurement | - | 32,891 | 5,526 | 5,526 | - |
| 4 Finance | 2,234 | 7,531 | 1,265 | 3,499 | - |
| 5 Treasury | 2,973 | 10,373 | 1,743 | 4,716 | - |
| 6 Risk Mgmt | - | - | - | - | - |
| 7 Int Audit | - | 155,207 | 26,075 | 26,075 | - |
| 8 Human Resources | 40,938 | 214,516 | 36,039 | 76,977 | (61,092) |
| 9 Info Services | 378,983 | - | - | 378,983 | (10,978) |
| 10 Corp Affairs | 9,680 | 32,621 | 5,480 | 15,160 | (16,500) |
| 11 Env Affairs | 5,340 | - | - | 5,340 | (4,306) |
| 12 Legal | 3,414 | - | - | 3,414 | - |
| 13 G.O. Security | 6,114 | 15,383 | 2,584 | 8,698 | - |
| 14 G.O. Facility Maint. | 295,486 | - | - | 295,486 | - |
| 15 Corp Depreciation | 135,460 | - | - | 135,460 | - |
| 16 Corp Property Tax | 16,329 | - | - | 16,329 | - |
| 17 Misc Costs | 223,739 | 9,175 | 1,541 | 225,280 | (215,255) |
| 18 Corporate Insurance | - | 508,965 | 85,506 | 85,506 | - |
| 19 Outside Prof Services | 84,098 | 988,883 | 166,132 | 250,230 | (365,753) |
| 20 Cust Svcs | - | - | - | - | - |
| 21 Rates | - | - | - | - | - |
| 22 Marketing | - | - | - | - | - |
| 23 Strategic Growth | - | - | - | - | - |
| 24 Community Investment | - | - | - | - | - |
| 25 External Communication | - | - | - | - | - |
| 26 rounding adjustments | 78,387 | - | - | 78,387 | - |
| 27 Total | <u>1,283,175</u> | <u>2,375,409</u> | <u>399,068</u> | <u>1,682,243</u> | <u>(692,812)</u> |

note: column A represents nonlabor costs allocated specifically to Mfg division via cost drivers like # employees, % of time estimates, # of PC's, etc.



Summary of Pro Forma Impact of Disposition of the Manufacturing Division
on CSS Costs allocated to Citizens Gas

| Line No. | | A <u>Labor</u> | B <u>Benefits</u> | C <u>Non-Labor</u> | D <u>Total</u> |
|--|-------|-------------------|----------------------|-----------------------|-------------------|
| <u>CSS Costs Without Manufacturing:</u> | | | | | |
| 1 | Gas | 12,438,772 | 7,835,095 | 15,156,098 | 35,429,965 |
| 2 | Total | 15,490,824 | 9,802,926 | 19,683,726 | 44,977,476 |
| 3 | | 80.3% | 79.9% | 77.0% | 78.8% |
| <u>Test Year CSS Costs:</u> | | | | | |
| 4 | Gas | 11,805,824 | 7,389,072 | 14,409,474 | 33,604,370 |
| 5 | Total | 16,132,271 | 10,174,064 | 20,376,531 | 46,682,866 |
| 6 | | 73.2% | 72.6% | 70.7% | 72.0% |
| <u>Impact of Removal of Manufacturing:</u> | | | | | |
| 7 | Gas | 632,948 | 446,023 | 746,624 | 1,825,595 |
| 8 | Total | (641,447) | (371,138) | (692,805) | (1,705,390) |

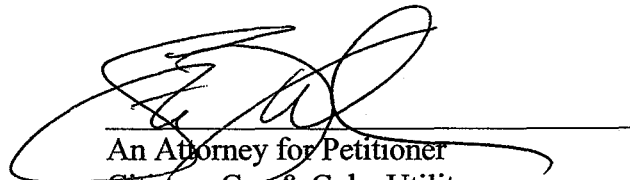


CERTIFICATE OF SERVICE

The undersigned hereby certify that a copy of the "Direct Testimony and Exhibits of Carey B. Lykins and John R. Brehm" was served this 17th day of March, 2008 by personal delivery or First Class United States mail on the following:

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Dear Dr. Sorenson: